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ADVERSE IMPACT OF THE FEDERAL BANKRUPTCY LAW  
ON THE GOVERNMENT'S RIGHTS IN RELATION TO THE  
CONTRACTOR IN DEFAULT

A Thesis

Presented to

The Judge Advocate General's School, United States Army

The opinions and conclusions expressed herein are those of the author and do not necessarily represent the views of either The Judge Advocate General's School, The United States Army, or any other governmental agency.

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ADVERSE IMPACT OF THE FEDERAL BANKRUPTCY LAW  
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ABSTRACT: This thesis examines the conflicts which arise between the Bankruptcy Code and the government contracts disputes resolution system when a contractor doing business with the Government files for bankruptcy protection. These conflicts severely limit the Government's ability to exercise its contractual remedies and prevent disruption of the procurement process. This thesis concludes that regulatory and legislative reform is only available to the Government in the limited areas concerning title to progress payment property and jurisdiction over liquidation of contractual claims.

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## I. INTRODUCTION

Historically, the Government has exercised its inherent power as the Sovereign to enter into contracts for the procurement of goods and services.<sup>1</sup> Since the Government's interest is to provide for the general public welfare, a certain deference has developed toward the exercise of these procurement powers.<sup>2</sup> In contrast, the federal bankruptcy laws have been a recognition of the welfare of the individual private business or consumer. In its own fashion, bankruptcy was also serving the public interest by rehabilitating the financially disabled. A comparison of the major provisions of the two systems clearly indicates that conflict must occur when a contractor doing business with the Government files a petition in bankruptcy.

When "two inclusive, exclusive, sweeping schemes"<sup>3</sup> such as bankruptcy and federal procurement overlap, procedural and substantive discord occurs unless careful legislative coordination has taken place in the drafting stage. Even a cursory analysis of the legislative histories of the Bankruptcy Code<sup>4</sup> and the federal statutes underpinning the procurement system reveals only haphazard coordination between the two. As a result, conflicting provisions and ambiguities, real or imagined, are guaranteed to provoke needless litigation involving the Government, the contractor [hereinafter also referred to as the debtor] the trustee, and other creditors of the debtor. Unfortunately, the consistent guidance needed to avoid these conflicts is lacking.

Under the present bankruptcy system, there is very little which can be done prior to the contractor's filing of the bankruptcy petition to

prevent the disruption and harsh results suffered by the Government as a creditor in a bankruptcy proceeding. In bankruptcy, the date of the petition filing is a watershed that drastically changes the relationship between the Government and the contractor. One illustration of this is if the Government exercises its contractual rights to terminate an unsatisfactory contract with the debtor one day prior to the petition filing, there is no ongoing contractual relationship for the bankruptcy trustee or court to exercise power over. In this situation, once discharged from continuing performance under the previous contract, the Government is free to contract for that need elsewhere.

In contrast, once the petition is filed, the bankruptcy system, not the Government, controls the existence or termination of rights under the contract. Even if the Government had acted prior to the petition, any ongoing contract litigation against property or funds of the debtor's estate is automatically stayed by the pending bankruptcy action. In this way, despite Governmental vigilance and prompt action at the first sign of impending bankruptcy, the contractor can always then file the bankruptcy petition and obtain protection from further contractual claims for money and property. However, the contracting officer who is faced with a contractor on the brink of bankruptcy should still aggressively assert the Government's rights until prevented by the bankruptcy court. One critical action is to obtain physical possession of property the Government claims title to under the progress payments clause. Once this is accomplished, the Government will usually be allowed to keep the property and defend instead against a monetary claim

for the value of the property. In this limited way, the Government may be able to facilitate reprocurement of the contracted for product, despite the continuing bankruptcy litigation against the previous contractor and the trustee.

Some statutory or regulatory relief for the Government also appears possible in the relatively narrow areas of progress payment property title, and jurisdiction over claims liquidation. Realistically though, there are no satisfactory solutions to the Government's loss of control over the contract and the funding obligated to it.

A proper understanding of the driving policy forces behind these two complex, self-contained legal systems is necessary to any attempt to identify which problems are solvable and which are not. Identification and analysis of these issues and the present status of litigation concerning them will also provide a detailed look at the approaches being used by the courts in this murky area. A good grasp of policy will assist in determining what is the better judicial approach under current law. With no sweeping statutory or regulatory change practically possible, the Government must identify the most feasible litigation strategies in order to protect its interests.

First, in order to acquaint the reader unfamiliar with one or both of the arcane fields of bankruptcy and Government contracts, Chapter II will provide a brief survey of some of the relevant federal statutes and regulations in these areas. The historical development of bankruptcy and federal procurement policy will be detailed to provide the background for the current conflict between the two systems. Critical provisions covered include: the nature of the debtor's

estate; the powers of the trustee to preserve the estate; the Government's immense powers in a typical procurement contract; and the comprehensive contract disputes system in federal contract litigation.

Chapter III will go on to identify and analyze the conflicts between bankruptcy and government contract law. Issues covered include: bankruptcy limitations on the Government's power to terminate a contract and pursue other contractual remedies against the debtor; methods whereby the Government may obtain relief from bankruptcy's automatic stay provisions; bankruptcy jurisdiction over liquidation of contract claims; and ownership, possession and title to property under the contract and bankruptcy law.

Finally, conclusions and proposed solutions are presented in Chapter IV.

## II. SURVEY OF THE BANKRUPTCY CODE; REMEDIES AND DISPUTES RESOLUTION UNDER THE FEDERAL PROCUREMENT SYSTEMS

### A. Bankruptcy System

Bankruptcy serves a role in corporate life eerily similar to that of the doctrine of reincarnation in some eastern religions.<sup>5</sup>

Just as reincarnation promises a new life, bankruptcy is designed to legally resurrect the financially deceased. Historically, one of the main purposes of the bankruptcy code has been to relieve a debtor "from the weight of oppressive indebtedness and permit him to start afresh from the obligations and responsibilities consequent upon business misfortunes."<sup>6</sup> Congress has spoken of bankruptcy law as a fundamental protection which "gives the debtor a breathing spell from his creditors...to attempt a repayment plan, or reorganization plan or simply to be relieved of the financial pressures that drove him into bankruptcy."<sup>7</sup> As a compliment to the policies favoring rehabilitation of the debtor, another reason articulated by Congress is the protection of creditors through establishment of "an orderly liquidation procedure under which all creditors are treated equally."<sup>8</sup> Apart from the moral basis for saving the individual debtor, numerous economic arguments in favor of bankruptcy are based instead on protecting the creditors and economy as a whole.<sup>9</sup> This rationale would also include protection of the Government in its contractual creditor's role in procurement.

A major body of law has developed from these

policy roots. In searching for the genesis of bankruptcy, the starting point must be the United States Constitution.

## B. Bankruptcy's Constitutional, Statutory, and Regulatory Structure

### 1. The Constitutional and Federal Nature of Bankruptcy

Under the United States Constitution, Congress has the power to enact bankruptcy law.<sup>10</sup> After several abortive attempts, a continuous bankruptcy system was finally enacted, starting in 1898.<sup>11</sup> Although Congress could have exercised this constitutional grant of authority to create a sweeping body of law to cover all aspects of bankruptcy, the present system has not excluded all application of state law.<sup>12</sup> The Bankruptcy Code is designed to use pre-existing state law as a starting point from which the bankruptcy court proceeds in exercising its federally based statutory and equitable powers.<sup>13</sup> An excellent example of this interaction is seen in how the Code defines creditors and claims in Sections 101(9) and 101(4).<sup>14</sup> Under these sections, a creditor is an entity (to include the Government),<sup>15</sup> with a right to payment or some equitable relief against the debtor. Since no all-encompassing system of federal common law exists,<sup>16</sup> state law is used to initially define whether a claim, and thus a creditor, exists.

While the Bankruptcy Code does have certain basic rules of claim priority,<sup>17</sup> these distribution priorities only apply to unsecured claims against the debtor. As a general rule, perfected security

interests in collateral included within the debtor's property are satisfied before any distribution to unsecured claimants.<sup>18</sup> In turn, the vast majority of the states have adopted some form of Article 9 of the Uniform Commercial Code to provide the rules governing formation and perfection of security interests.<sup>19</sup> It is the application of these state laws to the government procurement area which has caused continuing disagreement over the true meaning of progress payment title vesting provisions found in Part 32 of the FAR.<sup>20</sup> A full discussion of the difficulties encountered in determining which law is applicable, i.e. federal or state, is contained in Chapter III.

## 2. Statutory Development in the 20th Century and the Bankruptcy Reform Act of 1978

While a full treatment of the development of the present Bankruptcy Code is beyond the scope of this paper, identification of continuing problems in this area, especially in jurisdiction, is necessary for a later appreciation of the jurisdictional conflicts with the federal procurement system.

The history of the development of the present bankruptcy system is not a model of order and simplicity. Congress was uncertain on what mechanisms were necessary to effectuate those goals. Starting with the Bankruptcy Act of 1898,<sup>21</sup> Congress slowly assembled an unsatisfactory pastiche of laws which remained in effect until 1978.

Immediately prior to 1978, bankruptcy "judges" and "courts" were mere adjuncts to the federal district courts, dependent upon them for existence and

jurisdiction. Concern developed over the propriety of splitting jurisdiction over a case between a non-Article III<sup>22</sup> bankruptcy judge and the Article III district court judge, depending upon whether the specific issue was under title 11 or was merely related to it.<sup>23</sup> The problems of the bankruptcy court's lack of independence, the jurisdictional dependence upon the district courts and vast changes in the area of commercial law finally led to the concerted push for comprehensive legislative reform.<sup>24</sup> Following lengthy investigation and hearings,<sup>25</sup> Congress enacted the Bankruptcy Reform Act of 1978.<sup>26</sup> Under this Act, the United States District courts were granted original and exclusive jurisdiction over bankruptcy[hereinafter also referred to as Title 11] and non-exclusive jurisdiction over related non-bankruptcy proceedings as well.<sup>27</sup> In order to provide for independence from the district courts, the respective bankruptcy court of each district was also fully authorized to exercise this jurisdictional grant.<sup>28</sup>

Although Congress had provided the bankruptcy judge with the jurisdiction of an Article III federal court, the bankruptcy judge was only appointed pursuant to Article I. In Marathon Pipeline, the U.S. Supreme Court struck down this attempt to grant Article III jurisdiction to a non-Article III bankruptcy judge.<sup>29</sup> Despite several stays in the decision to allow a legislative correction of the system in accordance with the opinion, no Congressional action was taken before the second stay was vacated on December 24, 1982.<sup>30</sup>

3. The Emergency Rule and the Bankruptcy Amendments and Federal Judgeship Act of 1984.

Since Congress had failed to reach any consensus on how to deal with the mandate of Marathon Pipeline, an interim Emergency Rule was proposed by the administrative office of the Supreme Court and adopted by the federal courts to correct the jurisdictional defects of the bankruptcy system.<sup>31</sup> The Emergency Rule was later adopted legislatively as the Bankruptcy Amendments and Federal Judgeship Act of 1984, so no separate treatment of the content of the Rule is necessary here.

Under the 1984 Amendments, the district courts retained their previous broad jurisdiction while the bankruptcy court was stripped of any separate jurisdictional grant.<sup>32</sup> Currently, the bankruptcy judges are part of each district court,<sup>33</sup> and the district court judge can refer any case "under Title 11 and any or all proceedings arising under Title 11 or arising in or related to a case under Title 11..." to the bankruptcy court.<sup>34</sup>

Since the district courts, and through them the bankruptcy courts, exercise exclusive jurisdiction over "core" proceedings arising under Title 11, other federal and state courts must defer to them. In contrast, when a case is only related to Title 11, the issue of state jurisdiction and bankruptcy court abstention is very complex and remains unsettled.<sup>35</sup> Of more immediate concern to the Government however, is the more limited issue of deferring federal contract disputes resolution to an alternate federal forum.

#### 4. Bankruptcy Rules

Responsibility for promulgating rules to govern the practice and procedure in bankruptcy is vested in

the U.S. Supreme Court.<sup>36</sup> Pursuant to this authority, the present Bankruptcy Rules were prescribed, effective August 1, 1983.<sup>37</sup> While the Bankruptcy Rules are tailored to meet the special needs of the area, both the Federal Rules of Evidence and substantial portions of the Federal Rules of Civil Procedure are incorporated by reference.<sup>38</sup> Due to the essentially normal federal nature of the rules practice, only specific rules of special importance to bankruptcy will be commented upon.

### C. Critical Bankruptcy Provisions

#### 1. Chapter 7 Liquidation and Chapter 11 Reorganization

Title 11 is divided into eight major chapters with three general administrative chapters,<sup>39</sup> and five operative chapters.<sup>40</sup> Most provisions of the three general chapters apply to the operative chapters.<sup>41</sup> By far the largest number of cases dealing with a government contractor come under the provisions of two of the operative chapters, Chapter 7 or Chapter 11.<sup>42</sup> Further discussion of bankruptcy will be limited to cases filed under one of these two chapters unless otherwise stated.

Generally, Chapter 7 deals with the complete liquidation of the debtor's estate with some exceptions made for certain property and claims.<sup>43</sup> In contrast, Chapter 11 provides for a resolution of the claims against the estate while allowing the debtor to reorganize for eventual re-emergence from bankruptcy as a viable business concern.<sup>44</sup> The twin options of liquidation and reorganization are available to both

business entities and individual debtors, with some exceptions in the remedies allowed to each. While Chapter 11 was created primarily to deal with corporations, partnerships, and other business entities, reorganization relief is available to individuals, though difficult to administer.<sup>45</sup> In contrast, individuals, but not business entities, are afforded the right to be generally discharged under Chapter 7 from liability for most categories of debt.<sup>46</sup>

Choosing between liquidation and reorganization is the initial question which can govern the entire bankruptcy proceeding.<sup>47</sup> If a debtor selects liquidation under Chapter 7, there is no question of carrying on the business for other than a very short time span.<sup>48</sup> The trustee will see to the liquidation of assets<sup>49</sup> and terminate many of the debtor's executory contracts.<sup>50</sup> Focus of the proceedings shifts to evaluation of claims made against the estate.

Reorganization under Chapter 11 actually combines a form of controlled liquidation with a plan to restore the debtor's fiscal health. Either the debtor, who may remain in possession of the estate, or a trustee, will continue to operate the business while creditors' claims are resolved.<sup>51</sup> A higher percentage of executory contracts can be expected to be assumed by the trustee or debtor in possession during reorganization than under a Chapter 7 liquidation.

By their nature, Chapter 11 cases, containing both the elements of liquidation and continuation of the business, pose a more difficult long-term problem to the Government than the more straight-forward termination provided by Chapter 7. One such concern appears to be the greater reluctance bankruptcy judges have in providing certain kinds of creditor relief

against a debtor's estate when reorganization is involved.<sup>52</sup>

## 2. The Trustee and the Estate

Both the figure of the trustee and the concept of the debtor's estate are central to the conflicts resulting from the government contractor filing for bankruptcy protection. First, the trustee is the critical figure appointed by the court to perform the numerous duties required to either liquidate an estate or to promote a reorganization. Although a trustee will always be appointed under Chapter 7,<sup>53</sup> an option exists under Chapter 11 where the debtor may remain in possession of the estate instead, in order to continue operations.<sup>54</sup> While the trustee and the debtor in possession are considered to be legally different entities from the "original" debtor,<sup>55</sup> they stand in the debtor's shoes, with all attendant legal rights.<sup>56</sup> Since the trustee and debtor in possession have the same basic legal characteristics, any further discussion concerning a trustee will also apply to the debtor-in-possession unless otherwise stated.

Next, the estate is a vital concept since bankruptcy generally controls only what is included within it. The estate is created by the filing of a petition in bankruptcy, and is basically composed of all property in which the debtor has some legal or equitable interest.<sup>57</sup> Once the estate is created, the debtor's property is turned over to the trustee to be dealt with appropriately.<sup>58</sup> Any other entity holding such property, including the Government, is prohibited from taking any action other than preserving the property and turning it over to the trustee.<sup>59</sup> Of

particular interest to the Government is the extremely broad and loose interpretation of what comprises the "estate", and the inclusion of executory contracts,<sup>60</sup> and causes of action<sup>61</sup> in it. Executory contracts include both current contracts with some performance remaining by both parties as well as contracts where no performance has commenced.<sup>62</sup> Under the Bankruptcy Code, the trustee decides whether to assume or reject an executory contract on behalf of the debtor's estate. Rejection in turn, provides the other party to the contract with a separate claim against the estate for breach damages.<sup>63</sup>

### 3. Preservation of the Estate

Certainly the most critical features of the bankruptcy system are the provisions for collecting the estate property, and protecting its creditors' depredations. Under the Bankruptcy Code, an automatic stay provision acts immediately to halt most judicial and administrative proceedings against the debtor or estate,<sup>64</sup> and the trustee is able to void certain transfers of the debtor's property<sup>65</sup>. Concerning future attacks on the debtor, governmental refusal to grant or renew a franchise, license or permit or even refusal to contract with the debtor may be considered discrimination because of the debtor's bankruptcy status, and prohibited.<sup>66</sup> All of these protection devices are given a broad interpretation to foster bankruptcy's stated goals of allowing the debtor a respite and chance to start again with a relatively clean slate.<sup>67</sup>

The staying power under subsection 362(a) and the anti-discrimination rule under subsection 525(a) in

particular have very serious consequences for the Government. Although there is no exception if subsection 525(a) is applicable to an action, the Government may obtain relief from stay when exercising police or regulatory power under subsection 362(b)(4) in certain actions against a debtor.<sup>68</sup> Even these exceptions however, are narrowly construed,<sup>69</sup> and usually do not result in diminishment of the estate.<sup>70</sup> Of more practical use to the Government is the relief from stay based on good cause under the general provisions of subsection 362(d)(1).<sup>71</sup>

#### D. Federal Procurement Policy Concerning Remedies and Disputes Resolution

In the Federal Procurement area, the basic policies behind the current statutory and regulatory system range from a desire to ensure the Government is getting the best deal it can, to "promoting fair dealings and equitable relationships with the private sector."<sup>72</sup> While both of these policy directions are reflected in the rules governing remedies and disputes resolution between the Government and the private sector, a strong desire to protect the public interest appears to outweigh the individual contractor's interest in many situations. A survey of the major applicable federal statutes and regulations demonstrates the bias in favor of protecting government interests when a contractual arrangement degenerates into conflict.

#### E. Primary Statutory and Regulatory Structure Concerning Contract Administration, Termination of the Contract and the Rights of the Parties

## 1. Historical Development

Early recognition existed of the need for governmental flexibility in procuring necessary supplies and services. As early as 1875, the U.S. Supreme Court recognized the Government's inherent right to terminate a contract for its convenience when in the public best interest.<sup>73</sup> Contract clauses reserving the Government's right to unilateral termination for convenience were also held valid and enforceable.<sup>74</sup> These clauses also allowed the Government to reduce the damages a contractor would ordinarily recover at common law for breach of contract.<sup>75</sup> In a complimentary fashion, the Government's common law remedies against a contractor in breach have been expanded by the terms of the contract.<sup>76</sup>

The procurement systems established by the various executive agencies to take advantage of these contractual remedies resulted in a "needlessly complex, diverse, uncoordinated, outdated and...wasteful," regulatory structure.<sup>77</sup> In an attempt to remedy the system, Congress established the Office of Procurement Policy in 1974 with the mandate to provide central planning and coordination.<sup>78</sup> To further procurement reform, a uniform Federal Acquisition Regulation (FAR) was promulgated in 1984.<sup>79</sup> While the FAR is a broad regulatory framework covering almost every aspect of contract formation and administration, further discussion will concentrate on the provisions governing termination of contracts,<sup>80</sup> financing of contracts<sup>81</sup> and disputes resolution.<sup>82</sup> To simplify further discussion, the FAR clauses incorporated in ordinary supply contracts will be used as examples.

With regard to the termination of performance under a procurement contract, even a cursory examination of the FAR reveals a bias in favor of protecting the Government. Present remedies allowed to the Government include both common law remedies<sup>83</sup> and certain exclusive rights under the numerous FAR clauses inserted in the contract. The exclusive rights include both original remedies such as the right to terminate a contract for convenience,<sup>84</sup> and modifications of common law remedies such as the right to recover excess procurement costs as damages from a defaulting contractor.<sup>85</sup>

Another indication of the Government's favorable status is contained within Part 32 of the FAR, Contract Financing. Since adequate contractor financing is critical to the success of any commercial venture, the Government has undertaken to remove fiscal uncertainty in certain procurements, by providing financial support in addition to a contractor's normal financing. In Part 32, the Government assumes the responsibility of providing financing in appropriate situations to the contractor in order to ensure "prompt and efficient performance."<sup>86</sup> Financial assistance may come in the form of loan guarantees,<sup>87</sup> advance payments,<sup>88</sup> or progress payments.<sup>89</sup> Under Part 32 and the related contract clauses in Part 52, the contractor is subjected to a detailed system of financial checks and balances to protect the Government's monetary and other interests. The most important of these provisions calls for the vesting of government title "to all of the materials, work-in-progress, finished goods, and other items of property...under the contract under which progress payments have been made."<sup>90</sup> Other subparts provide for

the formation of paramount liens in favor of the Government over unliquidated advance funds provided under Part 32.<sup>91</sup> Substantial protection is afforded the Government by these types of contract clauses. It should come as no surprise that ownership of funds and property purportedly covered by these specific provisions is one of the most controversial issues arising from the application of the Bankruptcy Code to the rights of the parties in a government contract.

Part 33 of the FAR also provides for the making of claims by or against the contractor for monetary or other appropriate "relief arising under or relating to the contract."<sup>92</sup> Claims disputes and appeals concerning contested claims are also covered by this Part. Since Part 33 applies the Contract Disputes Act of 1978<sup>93</sup> to all implied or express contracts coming under the FAR,<sup>94</sup> a survey of the statute is in order.

## 2. The Contract Disputes Act of 1978

Just as the FAR was designed to bring order to the overall government procurement system, the Contract Disputes Act of 1978 was enacted to "provide a fair, balanced, and comprehensive statutory system of legal and administrative remedies in resolving Government contract claims."<sup>95</sup> Prior to the Act, contract claims were controlled by the Government's contractual Disputes Clause which forced contractors to exhaust agency remedies through agency-created boards of appeal prior to filing suit in the courts.<sup>96</sup> An unsatisfactory "mixture of contract provisions, agency regulations, judicial decisions, and statutory coverage," encouraged forum shopping and a power struggle between the courts and boards having

jurisdiction over various types of contractual claims.<sup>97</sup> In response to these problems, the Act served to remove jurisdiction over contract disputes from the U.S. District courts<sup>98</sup> and to establish a resolution scheme which emphasized negotiation before litigation.<sup>99</sup> The Act provided statutory authority for the creation of the present agency boards of contract appeals which have jurisdiction concurrent with the Court of Claims (since renamed as the Claims Court).<sup>100</sup> All further discussion concerning these boards will refer to the Armed Services Board of Contract Appeals [hereinafter referred to as the Board or the ASBCA] unless otherwise stated.

Under the Act and the FAR, all contractor or government claims must first be submitted to the agency contracting officer for a final decision on the merits of the claim.<sup>101</sup> Although the Government must submit its claims as well, this usually only becomes important when the Government attempts to counterclaim once the contractor has appealed the contracting officer's final decision. Accordingly, this discussion focuses on a contractor's claims. A contractor's failure to submit the claim to the contracting officer prevents the Board or Claims Court from exercising their appellate jurisdiction over the matter.<sup>102</sup> After the contracting officer's final decision is rendered or if no decision has been reached within a certain time,<sup>103</sup> the unsatisfied contractor may appeal only to either the Board<sup>104</sup> or to the Claims Court.<sup>105</sup> A further appeal may then be made to the U.S. Court of Appeals for the Federal Circuit which has exclusive jurisdiction over all contract appeals arising from the Board,<sup>106</sup> and Claims Court.<sup>107</sup> Since no other review of a contracting officer's final decision is allowed,

the Board, Claims Court, and Federal Circuit have exclusive jurisdiction over contract disputes under the Act.

While other statutory bases exist for the Government collection on debts,<sup>108</sup> and for providing contractor relief,<sup>109</sup> the vast majority of government contract disputes are dealt with under the Contract Disputes Act structure. Accordingly, further discussion of contract disputes resolution will be focused on the Act and the appropriate FAR provisions.

### III COLLISION BETWEEN BANKRUPTCY AND THE FEDERAL PROCUREMENT SYSTEM

#### A. General

The contractor considering the protection of bankruptcy will probably be experiencing difficulties in performing its government contract. Unrealistic delivery estimates, unanticipated costs or any of a myriad of problems may have beset the contractor. Whether the Government is to blame for the situation is immaterial to the immediate financial problems a termination for default would cause. Bankruptcy thus becomes the contractor's refuge from the Government's powerful remedies under the contract and applicable regulation.

Upon the filing of the bankruptcy petition, the contractor is transformed into a debtor, protected by the automatic stay provisions,<sup>110</sup> and the Government becomes merely one of numerous creditors.<sup>111</sup> From the contracting officer's or program manager's point of view this loss of special status is nothing less than a catastrophic degradation of their ability to carry out the procurement mission. Lengthy delays, funding problems, and protracted litigation in a strange forum are but a few of the possible difficulties to be faced.

Nonetheless, the protection the debtor and other

competing creditors receive in bankruptcy is in accordance with Congressional bankruptcy policy.<sup>112</sup> The Government must accept the fates which have brought it to the bankruptcy court and attempt to make full use of its remaining specialized legal remedies as well as those rights afforded to any creditor. From the Government viewpoint, this may seem meager in comparison to how it usually stands against the contractor. Without the ability to terminate the contract, immediately recover inventory and property, or enforce numerous claims under the contract, the Government must vigorously pursue its remaining remedies or be left out in the cold by creditors and lenders more experienced in security interests and the pitfalls of bankruptcy.

Further discussion will focus on three main problem areas: termination of the contract, recovery of property from the debtor, and liquidation of claims. While each is a separate issue, not necessarily related to the resolution of the others, each must be analyzed against the common backdrop of the automatic stay.

#### B. Bankruptcy Impact on the Contract

##### 1. Bankruptcy Limitations on the Government's Ability to Terminate the Contract and To Pursue Other Remedies Against the Contractor

One of the Government's first concerns when a contractor goes into bankruptcy, is the status of the contract itself. The continued existence of the contract critically affects the fiscal obligation of funds to that particular contract and the Government's ability to reprocure.<sup>113</sup> As previously indicated in Chapter II, the automatic stay provision prohibits the Government from exercising its administrative and

contractual rights under the FAR to take any action against estate property, whether it is inventory, funds, supplies, or the contract itself.<sup>114</sup> Instead, the continued existence of the contract depends upon factors such as which bankruptcy chapter the debtor petitions under; the trustee's decision of whether it is needed for a reorganization; whether it is still considered an executory contract under 11 U.S.C. §365; and other limitations on the ability of the trustee to assume the contract.<sup>115</sup>

This shift in power to the trustee negates both the Government's power to terminate a contract for default, and to terminate it for convenience. The practical result of each type of termination is to make a contract non-executory, which would put it beyond the reach of the trustee's assumption powers. It is this common result that will cause the bankruptcy system to treat these two quite different Government remedies alike. While the termination for convenience is the more favorable of the two remedies to the debtor, with some profit awarded, and no claim for excess procurement costs, the basic consequence of the action is the same: the loss of a contract that may be necessary to the debtor's reorganization. The weight of bankruptcy policy on this point should leave little doubt that no general exception will be made for the termination for convenience.

As a practical matter, the government will be faced with continuing an unwanted contract when the trustee has decided that it is necessary for an effective reorganization under Chapter 11. In contrast, under Chapter 7, the contract may be continued for a brief period of time,<sup>116</sup> but relatively quick termination is usually in order.<sup>117</sup> Once the

decision is made to assume the contract, the applicable provisions of section 365 of the Bankruptcy Code control.

In the usual bankruptcy situation, since the contractor has not completed performance, and the Government has not paid the full contract price, the contract is still executory and can be assumed as part of the estate.<sup>118</sup> If the contract is executory, the trustee, not the Government, decides pursuant to section 365 whether the contract is rejected or assumed. Should the trustee reject the government contract, a breach occurs and a damages claim is allowed as if the Government had terminated the contract for default before the bankruptcy petition filing.<sup>119</sup> In contrast, if the contract is no longer executory due to a completion of performance, i.e. payment, by the Government, section 365 no longer applies. The trustee may not assume the debtor's uncompleted portion of the contract and the Government is left to file a claim for breach.<sup>120</sup>

One limitation on the trustee's ability to assume the contract arises if the contract was in default at the time of the bankruptcy petition. In this situation, the trustee must promptly cure the default and provide appropriate guarantees of future performance before assuming the contract.<sup>121</sup> Practically, this restriction reduces the chances that the trustee will force the Government to continue the contract with an unreliable contractor. Such a "mini-responsibility" determination and guarantee of satisfactory performance somewhat offsets the Government's loss of its termination remedy. However, since the trustee makes the determination, subject to review by the court, the contracting officer's original

responsibility determination made pursuant to FAR 9.103<sup>122</sup> has been effectively superceded. The Bankruptcy Code shifts the decision to a trustee or a court without regard to the absence of the requisite expertise in government contract responsibility determinations. Under this system, the decision is made based on the Code's bias toward the rehabilitation of the debtor rather than the responsibility factors laid out in the FAR.<sup>123</sup> A better approach would be to include an individual with government contracts experience, such as the contracting officer, in this new defacto responsibility decision in order to bring the result more in line with the FAR.

2. Automatic Stay Relief for the Government Under the Police and Regulatory Powers Exception, 11 U.S.C. §362(b)(4)

Whether the regulatory and police power exception to the automatic stay is available depends upon what the Government's motive is for seeking relief, what kind of relief is sought, and how the estate is affected. The relief potentially provided by subsection 362(b)(4) consists of allowing another proceeding against the debtor to continue until resolved. Although removal of the debtor from the more protective bankruptcy court to a more favorable forum is obviously desirable from the Government's viewpoint, this relief from stay does not ordinarily translate into the freedom to terminate the contract or recover funds and property. Indeed, while this exception may be used to enforce policies promoting the public interest in many ways, subsection 362(b)(4) usually does not provide the Government with relief in

the procurement area for the following reasons.

Under subsection 362(b)(4), the automatic stay does not affect "an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power..."<sup>124</sup> The critical question of course is what type of action falls within the exception. The legislative history clearly indicates that the provision is designed to allow the Government to take action to "prevent or stop violation of fraud, environmental protection, consumer protection, safety, or similar police or regulatory laws..."<sup>125</sup> In narrowly interpreting this provision,<sup>126</sup> the courts have focused on the enforcement of general regulatory laws affecting the public health and safety,<sup>127</sup> rather than governmental attempts to enforce specific contractual rights.<sup>128</sup> Attempts to vindicate contractual rights have been judicially rejected as "actions by a governmental unit to protect a pecuniary interest in property of the debtor or property of the estate."<sup>129</sup> Thus, the two generally recognized tests<sup>130</sup> applied, focus on whether the government's action is primarily based on recovery of a pecuniary interest<sup>131</sup> or on the promotion of public policy.<sup>132</sup> Examples of valid exercises of the police power under subsection 362(b)(4) include unfair labor practice hearings,<sup>133</sup> Equal Employment Opportunity Commission hearings on sexual and racial discrimination,<sup>134</sup> and Environmental Protection Agency actions.<sup>135</sup>

However, there is no specific exception set aside for national defense needs under the police power doctrine, and the Government must meet the pecuniary and public policy tests noted above. This is a formidable task since the Government's remedies in the

procurement field are primarily pecuniary in nature and focus on the private rights of the parties involved rather than a more widespread group. Any government action which affects funds and other property properly included in the estate must clearly articulate a valid public policy reason to fit within subsection 362(b)(4).

The difficulty in meeting this burden is demonstrated by one court's holding that the Government failed to meet either test even where the case involved contractor fraud.<sup>136</sup> The Government had filed civil suit against the debtor based on fraudulent delivery of sub-standard metals to the Department of Defense. Although the suit sought damages under numerous theories, the Government argued that the action was brought primarily under the False Claims Act and was also necessary in order to determine if the metals had created a safety hazard to members or the Armed Services. The court refused to lift the stay, indicating since only one count of seventeen was under the False Claims Act, and other methods existed to determine if the metals had caused a physical danger, that the suit was not primarily based on a non-pecuniary purpose. This ruling is an example of the narrowest interpretation of subsection 362(b)(4), and obviously should not be read to imply that taking action against fraudulent contractors is per se an impermissible exercise of the Government's police powers. So long as attacking fraud is the primary reason for an action against a debtor, and not a subterfuge to protect the Government's pecuniary interest, the police power exception is satisfied.<sup>137</sup> One example of fraud which would obviously be within the exception is the situation where the fraud is

ongoing. An action against a contractor currently involved in defrauding the Government which is focused on stopping the illegal behavior and preventing its reoccurrence should be universally allowed to proceed.

One limited area related to fraud where government action should be considered a valid exercise of police and regulatory power is contractor debarment and suspension<sup>138</sup> under FAR subpart 9.4. Since suspension shares many of the characteristics of debarment, any further discussion of debarment will also apply to suspension unless otherwise stated.

Unlike the previously discussed Governmental actions which focused on obtaining monetary relief from the contractor, the stated policy of debarment is to ensure that the Government only deals with responsible contractors.<sup>139</sup> Debarment has traditionally been recognized as a proper and necessary tool for effective implementation of a statutory program, to include ensuring that only responsible bidders participate in Government contracts.<sup>140</sup> The FAR follows the judicially accepted approach that debarment is recognized as a serious sanction used to guard the public interest rather than punish the individual contractor.<sup>141</sup>

Thus, the stated purpose of debarment satisfactorily complies with the public policy and pecuniary purpose tests under subsection 362(d)(4). Under the FAR, debarment has a clearly articulated purpose of protecting the public interest by ensuring that only responsible contractors do business with the Government. Unlike the Government's contractual remedies, debarment is not an adjudication of the rights of the parties under the contract, but rather a vindication of the public's interest in a responsible

procurement system.<sup>142</sup>

Debarment also meets the pecuniary purpose test since the action ordinarily is not applied to current executory contracts,<sup>143</sup> and the Government is not otherwise attempting to enforce a monetary claim against the estate. Since the law is well settled that a contractor has no right to do business with the government,<sup>144</sup> no property interest of the estate is involved in the Government's refusal to award future contracts upon debarment. However, debarment is a limited action with prospective application that has little effect on the critical issues surrounding disposition of property, funds, and executory contracts.

### 3. Automatic Stay Relief for the Government Under Other Applicable Law and 11 U.S.C. §365(c)

As we have seen, the Government procurement remedies usually do not merit subsection 362(b)(4) exemption from the operation of the automatic stay. Also, any relief granted rarely extends to termination of the present contract or actual recovery of funds from the debtor. Unlike subsection 362(b)(4), section 365 of the Bankruptcy Code does provide the Government a more satisfactory approach to terminating an unsatisfactory contract with the debtor.<sup>145</sup>

Under subsection 365(c)(1) of the Code, the trustee may not assume an executory contract if applicable law prohibits assignment of the contract or otherwise excuses the other party from performing or accepting performance from a party other than the debtor or debtor in possession.<sup>146</sup> An attempt by the trustee to assume such a contract constitutes adequate

cause for relief from the automatic stay and the other party to the contract terminate it.<sup>147</sup> Judicial interpretation of this provision has differed considerably on what types of contracts are within the purview of this subsection. Some courts have called for a narrow, restrictive reading of the subsection to limit its application to contracts which traditionally involved nondelegable duties such as personal services.<sup>148</sup> In Taylor, the court based this interpretation on what it perceived to be a conflict between subsections (c)(1) and (f) of §365.<sup>149</sup> The better interpretation however, is that no real conflict exists and subsection 365(c) should be given its plain meaning without any undue limitation in application.<sup>150</sup>

The statute as written does not qualify or otherwise limit the applicable laws which may prohibit assignment of the contract. One court, in rejecting a "radical construction" limiting the section, points out that there is no indication in the legislative history that only personal service contracts were contemplated by the drafters.<sup>151</sup> Another court, in rejecting the restrictive approach of Taylor, has indicated that trying to determine if any particular contract is for personal services and thus unassignable, is an uncalled-for complication of an otherwise simple test under subsection 365(c).<sup>152</sup>

Subsection 365(c)(1) is relevant to government procurement due to the Nonassignment Act, which prohibits the assignment of federal government contracts by the contractor.<sup>153</sup> Such an attempt to assign will give the Government the option to terminate the contract. The Act was designed to protect the Government from having to deal with numerous different parties not originally within the contract and also to

ensure that the government obtains its performance from the original party to the contract.<sup>154</sup> The policy behind the Act has also been interpreted as being broader than the common law rule concerning personal performance contracts.<sup>155</sup> Without this protection, the contracting officer's responsibility determination under the FAR would be meaningless, and the Government might be faced with accepting performance from a non-responsible contractor.

As "applicable law" under subsection 365(c)(1), the Act has been construed to allow the Government to terminate executory contracts for default after a debtor in possession has attempted to assume them.<sup>156</sup> However, the Government's right to refuse to allow assumption has been qualified by some courts.<sup>157</sup> One such restriction would prevent termination unless there was a showing that the assignment of the contract might cause the problems the Act was designed to avoid.<sup>158</sup> Whether this qualification of the plain language of the Act survives the application of subsection 365(c)(1) is open to dispute. One court has indicated that since the Nonassignment Act satisfies the general requirement under subsection 365(c)(1), the Bankruptcy Code itself operates to preclude the contract assumption, whether or not the assumption might be mandated by operation of law outside of a bankruptcy situation.<sup>159</sup> Although this interpretation would strip previously imposed judicial limitations from the operation of the Nonassignment Act, the bankruptcy court could still adjust the equities as needed during the relief hearing under subsection 362(d). This is the better approach since the bankruptcy court is not required to delve beyond the surface of an anti-assignment statute to determine if the plain

requirements of subsection 365(c)(1) are met.<sup>160</sup>

Government contracts which incorporate certain financing provisions under Part 32 of the FAR, should also be exempt from assumption due to subsection 365(c)(2). The anti-assignment provisions in subsection (c)(2) apply whether or not any other applicable law would allow or prohibit assignment.<sup>161</sup> Subsection (c)(2) prohibits assumption of executory contracts which directly or indirectly extend financing to the debtor.<sup>162</sup> Since government contracts which incorporate loan guarantees,<sup>163</sup> advance payments,<sup>164</sup> or progress payments,<sup>165</sup> provide financing to the debtor,<sup>166</sup> subsection (c)(2) should block assumption by the trustee. Unlike subsection (c)(1), this limitation would also extend to an assumption by a debtor in possession.<sup>167</sup>

While the operation of the provisions of subsection 365(c) should enable the Government to reject assumption of the contract by the trustee or debtor in possession, many bankruptcy courts will undoubtedly hesitate to follow this strict interpretation due to its harsh results. Operation of such a statute acts to strip the court of its power to control contracts which may be critical to a successful reorganization. Because the bankruptcy court has the equitable power to reject laws perceived as causing an inequitable result, the Government's attempts to pursue this remedy will probably not be successful in many cases.

#### 4. Impact of Bankruptcy Discrimination Prohibitions under 11 U.S.C. §525 on the Government Contract

Apart from the Bankruptcy Code's impact on the

current contract with the debtor, the Government must also be concerned about the Code's protection of the debtor in the future. As previously discussed,<sup>168</sup> 11 U.S.C. §525(a), prohibits the Government from taking certain actions against the debtor if the action is based on the debtor's bankruptcy.<sup>169</sup> These provisions can have serious impact on the Government in two related areas. First, whether to exercise the options years in a contract is normally a discretionary decision made by the Government based solely upon its best interests.<sup>170</sup> Second, great deference is also given to a contracting officer's adverse responsibility determination due to the contractor's financial problems.<sup>171</sup> Bankruptcy however, has restricted the contracting officer's discretion in these matters, and provided pitfalls for the unwary.

The degree to which subsection 525(a) will affect the Government's actions depends upon whether the particular bankruptcy court follows a restrictive or expansive interpretation of what discrimination is prohibited. A restrictive interpretation basically limits the subsection's application to discrimination that resulted solely from the debtor's status, and "only differentiation between debtor and non-debtor is precluded by the statute."<sup>172</sup> A broad interpretation prohibits any discrimination which might thwart bankruptcy's general fresh start policy.<sup>173</sup> While the majority of bankruptcy courts favor a broad approach, the appellate courts generally follow the more conservative narrow interpretation.<sup>174</sup> However, since the Government should not assume that it will ultimately prevail at the appellate level, rigid compliance is needed to avoid yet another intrusion of the bankruptcy court into the procurement process.

Strict adherence to the spirit and letter of subsection 525(a) is difficult when the contracting officer is faced with the prospect of awarding new business to the debtor who may or may not be in default on other contracts. Under FAR 9.103, the contracting officer is required to make an affirmative finding that the contractor meets certain responsibility standards before a contract can be awarded.<sup>175</sup> Since a lack of adequate financial resources and a resulting problem in having the resources needed to meet a delivery schedule are normal in a bankruptcy situation, the contracting officer may make a nonresponsibility determination based solely upon the contractor's bankruptcy status or history. Such a decision is exactly what subsection 525(a) prohibits.<sup>176</sup> Although the precise language of subsection 525(a) refers to discriminatory hiring and employment practices, the courts have consistently interpreted this to include procurement contracting as well.<sup>177</sup>

While difficult, the task of complying with both the directives of subsection 525(a) and the FAR, is not insurmountable. Some guidance for what the contracting officer can properly consider may be found in the pertinent legislative history. Permissible factors include "future financial responsibility or ability,"<sup>178</sup> and "the factors surrounding the bankruptcy,...[and present] managerial ability."<sup>179</sup> A proper responsibility determination must be founded on a realistic evaluation of the ability to perform the contract, without regard to debtor's bankruptcy status. One should remember that in the bankruptcy arena, the contracting officer's nonresponsibility determination will be closely scrutinized by a forum which is operating under its own set of rules and guided by

differing policies. Once again, the Government's prerogative has been transferred to the bankruptcy court.

As previously mentioned, a second example of the impact subsection 525(a) has on the Government's contracting discretion concerns the exercise of option years in existing contracts. At least one court has held that the Government's refusal to exercise its option to extend a contract an additional year with a debtor undergoing Chapter 11 reorganization was prohibited discrimination.<sup>180</sup> In Exquisito, the Government had refused to exercise the option years in a food services contract which had been awarded to the debtor under the auspices of the Small Business Association's 8(a) Program. The court analogized the 8(a) program to a franchise where the Government contracted with the S.B.A. which in turn granted the exclusive performance rights to the debtor. After finding that the Government had not renewed the "franchise" solely because of the debtor's Chapter 11 petition, the court found the Government had violated subsection 525(a). As a result, the Government was required to renew the contract with the debtor. Despite the court's professed intent to limit the application of subsection 525(a), calling a government contract a renewable franchise is more in accord with a broad, than narrow interpretation of the statute. The better view, as the dissent in Exquisito points out,<sup>181</sup> is that a government contract whether awarded through the auspices of the S.B.A. or not, should not be considered a grant of privilege under subsection 525(a), since no one has the right to do business with the Government. Since the franchise analogy depends upon the intervention of the S.B.A., the court's

rational cannot be extended to contracts an agency directly awards to a contractor. As a result, subsection 525(a) would be applied to 8(a) contracts only, with no justification under bankruptcy policy for the disparate treatment of similar contracts not under the S.B.A. program.

Although Exquisito should be considered an unjustified expansion of the scope of subsection 525(a), the same result might have been reached had the court decided that the Government's refusal to renew the contract was discrimination in the employment sense. Such an interpretation would require a broad application of the statute, but as discussed earlier, numerous courts are willing to do so in the cause of protecting the debtor. Thus, while Exquisito should be read as being limited to its facts, the Government must ensure that contracting officers are educated to the impropriety of taking adverse action solely because a contractor is in bankruptcy. The remedy granted in Exquisito would be a much harsher lesson indeed.

### C. Bankruptcy Jurisdiction and Liquidation of Claims

#### 1. Bankruptcy Court Deference on Liquidation of Contractual Claims

Unlike the methods previously suggested which may allow the Government to terminate a contract, no automatic stay relief exists for expeditious recovery on monetary contractual claims. The Government's right to recover unliquidated progress or advance payments, excess procurement costs, and other breach damages, is reduced to a low-priority claim against the estate. In addition to the Government's claims, the debtor or

trustee also normally raise counterclaims under the contract against the Government. These claims may be for equitable adjustments under the contract, a termination for convenience settlement, and damages for a wrongful termination for default, to name but a few.

Adjudication of these claims is often a difficult and lengthy process which ordinarily is accomplished pursuant to the Contract Disputes Act of 1978. However, in cases under Title 11, "[t]he bankruptcy court normally supervises the liquidation of claims,"<sup>182</sup> whether or not another forum exists to resolve the claim.<sup>183</sup> Arguably, one Government goal is to remove the debtor from the bankruptcy forum, which is biased toward rehabilitating the debtor, to the ASBCA or Claims Court which are more experienced in government contracts, and unconcerned with saving the debtor from financial distress. This approach presumes that as a general rule, the more knowledgeable the forum, the less likely the debtor is to prevail in the liquidation of the parties' contract claims.

The majority of courts which have addressed this issue have deferred liquidation of government contract claims to the more specialized forum. In the typical case, the Government has either challenged the bankruptcy court's jurisdiction as being inconsistent with the Contract Disputes Act, or moved to have the court defer the matter to resolution by the ASBCA. The practical effect is that the contract claims are processed de novo pursuant to the Contract Disputes Act, and the resulting liquidated monetary judgement is then filed in the bankruptcy court as a claim for or against the estate. Whichever party is making the claim bears the responsibility for initiating the claim, which should include making the claim through

the contracting officer if this has not already been done. Only then would the contested claim go to the ASBCA or Claims Court for final decision on its validity and quantum of recovery.

In Gary Aircraft, a leading pre-Contract Disputes Act case, the court thoroughly analyzed the provisions, policies and histories of the Bankruptcy Act of 1898, and federal procurement statutes and regulations in order to resolve the conflict between them.<sup>184</sup> In deciding to defer to the ASBCA, the court considered the nature of a bankruptcy court's discretion to defer to another forum for claims liquidation; the exclusive jurisdiction of the Court of Claims in resolution of claims against the Government; the use of the Board of Contract Appeals would not unduly delay the bankruptcy proceeding; the esoteric nature of government procurement law; and the expertise of the ASBCA in this area of law.<sup>185</sup> In promulgating the rule of deferment, the court declined to rule on the issue of whether the bankruptcy court had jurisdiction over the claim.<sup>186</sup>

Although deferment to other administrative bodies is not universally accepted in bankruptcy,<sup>187</sup> the cases which have since dealt with liquidation of claims in government contracts have followed Gary Aircraft.<sup>188</sup> Since the Claims Court is of like stature with the Boards of Contract Appeal under the Contract Disputes Act, there should not be any reason for the bankruptcy court to limit in which forum the parties can liquidate their claims.<sup>189</sup> Deferment continues to be a matter of discretion in the bankruptcy court, subject to the needs of each particular case. Government attempts to argue that the Contract Disputes Act and its exclusive jurisdictional scheme<sup>190</sup> have divested the bankruptcy courts of jurisdiction over government contract claims

have been rejected.<sup>191</sup> While the bankruptcy court arguably needs such discretion and flexibility to best settle the estate, it should be the rare case where the court should not defer to the statutorily mandated contract disputes resolution system. The bankruptcy interest is adequately vindicated by the expeditious liquidation and return of the claim to the bankruptcy court, since as a rule, collection of a monetary judgement cannot otherwise be made against the debtor.<sup>192</sup>

D. Ownership, Title, and Possession of the Estate

1. Ownership of Funds and Material

One of the most bitterly disputed issues involving government procurement and bankruptcy concerns the status of funds and inventory held by the contractor in bankruptcy. A basic tenant of the Bankruptcy Code is that all property, tangible and intangible, in which the debtor has a legal or equitable interest will be included in the estate when the bankruptcy petition is filed.<sup>193</sup> Such property is protected by the automatic stay provisions of section 362 and will be subject to use and distribution by the trustee according to applicable bankruptcy law. If the debtor possesses property but has no accompanying ownership interest in it, the true owner is entitled to immediate relief from the automatic stay under subsection 362(d)(1), and recovery of the property.<sup>194</sup> However, if the creditor merely holds a lien or security interest in the property rather than complete title, then the property remains in the estate with usually no prospect of immediate relief from the bankruptcy court.<sup>195</sup>

Under the financing methods in Part 32 of the FAR,<sup>196</sup> the Government protects itself financially by using contractual clauses to reserve title to property and create paramount liens on unliquidated funds. These provisions are found in the progress payments clause and paramount lien provisions also exist in the advance payments clause. The clauses are used to defend the Government's interests not against the bankrupt contractor, but against the contractor's other creditors who are competing for the same remaining assets. The progress payments clause however, is of greater concern in bankruptcy than the advance payments provisions. Under the progress payments clause, the Government receives title to all inventory, work-in-progress, materials, and any other property which is properly allocable to the contract, as of the date of the contract or when the property should have been allocated to the contract.<sup>197</sup> If these title vesting provisions are given their plain meaning, the Government will be entitled to prompt recovery of the property from the estate, which in turn promotes speedy and efficient reprocurement. If the progress payment clause reserves title and not just a security interest, the Government also would not be required to file a financing statement or otherwise perfect its interest under any other federal or state law.

## 2. Title v. Lien Theory

Some recent courts and commentators have interpreted the progress payment clause as providing only a lien which must be dealt with just as any other security interest on property in the estate.<sup>198</sup> The arguments advanced to support the newer interpretation are based

on the historical development of government financing and policy arguments decrying any favored treatment of the Government in the procurement arena. However, the better interpretation continues to give literal meaning to the title vesting provisions of the progress payments clause. A careful review of both the historical background of this issue and the competing policies involved supports this proposition.

At the heart of the dispute lies a traditional statutory prohibition against advancement of funds on contracts in excess of performance already received by the Government. From 1823 to the present, some form of this prohibition against advance payments has existed.<sup>199</sup> This flat prohibition obviously required the contractor to obtain financing from other sources which was bound to negatively affect procurement in certain circumstances. Because of the potential for serious adverse effects on the procurement mission, a doctrine evolved whereby the government made partial or progress payments to contractors in exchange for a proportional vesting of title in the Government to the unfinished work.<sup>200</sup> In time, statutes were enacted to allow advance, but not progress, payments in certain types of procurement contracts.<sup>201</sup> Statutory authority for progress payments was finally provided in the 1958 amendment of the Armed Services Procurement Act.<sup>202</sup>

Although legislative recognition of the progress payment-title vesting doctrine was late in coming, the U.S. Supreme Court had previously recognized the concept's validity in Ansonia Brass, in 1910.<sup>203</sup> The court was faced with the interpretation of a progress payments type clause which vested title in the Government to a dredge under construction as

installment payments were made to the contractor. In finding that the contract provisions were clearly sufficient to pass title to the Government and defeat the liens of the contractor's materialmen, the court stated:

But it is equally well settled that if the contract is such as to clearly express the intention of the parties that the builder will sell and the purchaser shall buy the ship before its completion, and at the different stages of its progress, and this purpose is expressed in the words of the contract, it is binding and effectual in law to pass the title.<sup>204</sup>

The U.S. Supreme Court later had occasion in Allegheny County to expand on the nature of the Government's claim to property acquired under a progress payment type clause.<sup>205</sup> The court stated:

The validity and construction of contracts through which the United States is exercising its constitutional functions, their consequences on the rights and obligations of the parties, the title or liens which they create or permit, all present questions of federal law not controlled by the law of any state...Federal statutes may declare liens in favor of the Government and establish their priority over subsequent purchasers or lienors irrespective of state recording acts...We hold that title to the property in question is in the United States...<sup>206</sup>

The ability of the contractual language to pass title prior to the 1958 legislation was thus judicially accepted.<sup>207</sup> Regulatory guidance also incorporated title vesting as security for contractor financing. Under the Defense Contract Financing Regulations,

promulgated a few years prior to the 1958 amendments, title granting provisions were used to secure progress payments and related property.<sup>208</sup>

The 1958 amendment, codified in part as 10 U.S.C. §2307(c), did not explicitly provide for the reservation of title as security for progress payments. However, subsection 2307(c) refers only to using paramount liens to secure advance payments without any mention of progress payments at all.<sup>209</sup> While the legislative history is sparse on this issue, a letter from the Comptroller General to the Senate Committee on Government Operations indicated that progress payments should not be allowed unless some security device such as title reservation or a paramount lien on progress payment property was authorized.<sup>210</sup> In a recent well reasoned treatment of this issue, the court in American Pouch Foods concluded that Congress had intended to validate the traditional practice, already established in regulation and judicially recognized, of reserving title over progress payment property.<sup>211</sup> The validity and literal interpretation of progress payment title vesting provisions continue to be accepted by a majority of the courts.<sup>212</sup>

However, in Marine Midland, decided in 1982, the Court of Claims broke with the majority and held that the progress payment clause gave the government a lien rather than title to property covered by the payments.<sup>213</sup> While this position has consistently been followed in the Claims Court to the present,<sup>214</sup> Marine Midland has been criticized, and not followed by other jurisdictions.<sup>215</sup> The issue is alive and well however with at least one bankruptcy court writing in sympathy with Marine Midland,<sup>216</sup> and conversely, the Claims Court indicating that they would rather return

to the majority title position.<sup>217</sup>

Marine Midland began with a finding that the title vesting clause had simply been a legal mechanism to avoid the statutory advance funding prohibitions in effect before 1958. Once the need for the legal fiction of progress payment title was gone, the clauses existed only to provide a security interest or lien in the contractor's inventory in exchange for Government financing.<sup>218</sup> The court stressed that the nature of progress payment clause was consistent with the lien theory and inconsistent with the normal vestiges of ownership.<sup>219</sup> The court went on to indicate that this interpretation of the progress payments clause also operated to provide a superior lien creditor with a claim for the value of the property in question, and not the actual property which could not be withheld from the Government.<sup>220</sup> This approach enabled the court to distinguish Ansonia Brass and its progeny. Once having decided that the Government held only a security interest or lien, the court went on to create a federal common law rule giving the government lien priority only over general creditors.<sup>221</sup> However, the Court of Claims' approach in Marine Midland is suspect for several reasons.

The Court of Claims interpreted 10 U.S.C. §2307(c) to mean that Congress rejected the accepted practice of title vesting in progress payment property. Despite the court's general statement that the lien theory is not inconsistent with cases apparently accepting literal title vesting, the plain language of a majority of the applicable cases cannot be that easily reconciled with a lien approach.<sup>222</sup> Marine Midland attempted to finesse the issue by arguing that most of these cases litigated only the right to possession of

the property and not the potential follow-up claim by a superior lien creditor or the trustee for the value of the property taken by the Government. The Court of Claims relied in part upon Armstrong, in which the U.S. Supreme Court held that when the Government with a paramount lien took title to property already subject to a creditor's lien, the latter's lien was destroyed and an action to recover the value was allowed.<sup>223</sup> However, this is only logical due to the nature of a paramount lien which would leave title in the contractor where competing liens could validly attach. In contrast, under a literal interpretation of the progress payment clause, title vests in the Government at the contract date or as soon as the property is or should have been allocated to the contract. Since a creditor's security interest cannot be created until the contractor acquires rights to the collateral,<sup>224</sup> the vesting of title in progress payment property at the time of allocation should prevent attachment of the security interests per Ansonia Brass.<sup>225</sup> Once the court has ruled that the government has full title to the property through operation of the progress payment clause, there usually would not be any further need to litigate the existence or validity of a claim since other liens or security interests should not have attached to the property. The Armstrong scenario, where the Government takes title well after competing liens have attached, should be the exception rather than the rule in the progress payments area. Thus, the courts' literal application of title vesting is the reason why the cases apparently focus on the possessory aspect of ownership rather than a follow-up claim for the value of the extinguished lien. This result undercuts the Court of Claims' argument for a narrow

interpretation of the majority's literal title approach.<sup>226</sup>

The Court of Claims distinguished at least one other literal title case by simply indicating it was decided prior to acceptance of the U.C.C., and reservation of title was a legal fiction designed to protect what would now be characterized as a purchase money lender.<sup>227</sup> However, the court in Double H specifically rejected a lender's attempt to characterize the Government's title under the progress payments clause as a "paper title" security device.<sup>228</sup> Such a direct rejection is difficult to reconcile with the Court of Claims' dismissal of the case as one in which a literal interpretation of title vesting was necessary simply to uphold the use of an archaic security device.

Marine Midland and its progeny in the Claims Court should be seen not as a belated recognition that the lien theory is correct law, but as a policy-based attempt to bring title vesting in Government contracts into line with commonly accepted commercial practice under the U.C.C. This desire to modernize what the Court of Claims regarded as an old-fashioned form of security device is readily apparent in the following passage from Marine Midland:

The rule of decision we choose for this case is to make the government's security interest under its title vesting procedures paramount to the liens of general creditors. We believe that this merely follows the modern practice of giving priority to purchase money interests, as we consider purchase money to be closely analogous to the government's progress payments...<sup>229</sup>

### 3. Priorities Under the Lien Theory

Even if Marine Midland was assumed to be correct in stating that the title vesting provisions provided only a lien, the court's characterization of the lien as superior to those of general creditors is also suspect. Under a lien theory, the Government's interest should still be paramount to all other liens. This would at least provide the same protection to progress payments as the paramount lien provided for advance payments under 10 U.S.C. §2307.<sup>230</sup> Apart from the statutory paramount lien language, analysis of applicable law demonstrates the absolute priority lien is still the better rule.

Substantial guidelines have been laid down on how to determine the appropriate law governing the priorities of federal liens. In Clearfield Trust, the U.S. Supreme Court ruled that federal, not state law, controls any determination of the Government's rights under nationwide federal programs.<sup>231</sup> The Court stated that if Congress did not provide the rule, then the federal courts would fashion the appropriate law.<sup>232</sup> One year later, the Supreme Court specifically ruled that federal law governed questions about liens created by the Government's procurement contracts.<sup>233</sup>

In the absence of a federal statute, the question remains whether a uniform federal common law should be created, or applicable state laws adopted as federal law, or a combination of the two. In Kimbell Foods, the Supreme Court considered this issue and held that state law would be incorporated to control lien priorities under the federal loan programs conducted by the Small Business Administration and the Federal Housing Authority.<sup>234</sup> In making its determination, the

Court focused on several factors: whether the federal program required a uniform body of law; whether the use of state law would thwart the program's purposes; and also to what degree the adoption of a federal law would disrupt the states' commercial systems.<sup>235</sup> Since the federal agencies were already applying state law with no apparent hardship, the Court declined to adopt a uniform federal rule. However, Kimbell Foods indicated that uniform federal rules might be necessary to govern federal lien priority in order to "vindicate important national interests."<sup>236</sup>

The few courts which have followed the lien theory have split on the issue of whether the procurement area requires a uniform law or should state law be incorporated. Murdoch Machine used one state's version of Article 2, U.C.C., to determine the relative priorities between the Government and a seller with the right to withhold possession from an insolvent buyer.<sup>237</sup> The Government claimed that it had title to certain steel the contractor had ordered from a supplier prior to becoming insolvent. Under applicable state Article 2 sales law, the supplier argued that it had a right to withhold the steel from the insolvent contractor-buyer, and that the Government's title interest could not attach prior to actual shipment of the property. In comparing the Government to any other large company involved in interstate transactions, the court found that compliance with applicable state law would not cause hardship to the Government, and would eliminate the danger of secret liens to suppliers who were unaware of the government contract.<sup>238</sup>

Rather than adopting state law as federal law, the Court of Claims decided upon a uniform federal rule in

Marine Midland.<sup>239</sup> In deciding upon a uniform rule, the court distinguished Murdoch Machine on its facts,<sup>240</sup> and relied instead upon established federal practice, and the existence of Congressional policy favoring a uniform approach.<sup>241</sup> The rule provided that the progress payment clause gave the Government a lien which was superior to the rights of a general creditor. Although a uniform rule was enunciated, the court based it on an analogy to purchase money security interests under Article 9 of the Uniform Commercial Code.

Recent Claims Court decisions following Marine Midland, demonstrate the consistency problems with developing the federal rule using a case-by-case analogy to commercial law. In Welco, the court resolved the respective priority problem in favor of the Government by analogizing its interest to a purchase money security interest under the Article 9. The court went on to state:

It should be understood that the foregoing analysis is not intended to signal the court's adoption of state rules of priority as the basis for a federal standard. It may well be that the proper rule is one that calls for absolute federal priority.<sup>242</sup>

Conversely, the court in First Nat. Bank of Geneva, decided that the Government's interest in certain special tools under a progress payments clause was not like the purchase money interest since the funds were not directly related to the tools.<sup>243</sup>

Although Marine Midland correctly articulated some of the reasons why a uniform federal common law should be applied to govern federal procurement lien priorities, the rule adopted was complex and confusing. Also, limiting the Government's interest to a status less than a purchase money interest ignores the general

nature of progress payment and advance funds. To avoid uncertainty, and more closely parallel the advance payment lien, the rule of absolute federal priority speculated upon in Welco, is preferable to the Claims Court's present approach. However, the question should only be relevant for the Government's litigator in Claims Court and possibly the 10th Circuit, since the lien approach is not otherwise accepted.

#### 4. Policy Conflict Between Lien and Title Theory

While the merits of the policies behind literal title-vesting as opposed to lien theory are open to debate, the current state of the law still requires literal interpretation of the progress payments clause. Whether the Government should receive this favored treatment in the world of secured transactions is a more hotly contested issue than the actual state of the law. Certain commentators have caustically condemned the effect of the Government's title vesting provisions upon secured creditors and lenders.<sup>244</sup> Of considerable concern is the perceived inequity of allowing the Government to prevail over secured creditors without having to file a financing statement or otherwise perfect what the U.C.C. would regard as just another security interest.<sup>245</sup> One recent commentator noted that the Government's rights under the progress payments clause had been characterized as secret liens and that "[s]ecret liens are nasty little creatures."<sup>246</sup> One court stated that literal enforcement of the title vesting provisions was like dealing "wild cards to businessmen at random," and would result in injustice.<sup>247</sup> These critics usually call for a requirement that the Government's interest

be reduced to a security interest which must be perfected by filing in accordance with Article 9. However, this approach is not without flaws.<sup>248</sup>

In answer to this criticism, several factors must be addressed. First, it is true that progress payments are a form of financing device and that a security interest would appear at first glance to be an adequate method to protect the Government's interest in the unliquidated progress payments. Also, characterizing the Government's interest as a security interest would simplify treatment of the property under other FAR provisions covering inventory control, plant clearance and also reduce the liability exposure due to injury or damage caused by the progress payment property. However, it must be recognized that the Government's interests and the public interest goes beyond the monetary concern. Critical defense procurements simply cannot be considered just another purchase by a major corporation, however attractive the proposition may be to the competing business world. The public interest demands that material, systems and other property necessary to the national defense not be unreasonably encumbered or withheld from the Government.<sup>249</sup> While not applicable to every contract or inventory, this factor must be considered in an evaluation of the Government's position in respect to other creditors.

With this in mind, even a cursory attempt to bring progress payments security in line with the U.C.C. reveals a structural problem which may very well prevent the Government from adequately protecting either of the above mentioned interests. Ordinarily, the Government will be competing with the contractor's other suppliers and lenders who have previously

created security interests in the inventory. Under U.C.C. §9-203, these interests attach as soon as the contractor gains rights to the newly acquired collateral, i.e. supplies and inventory. However, under the progress payments system, the contractor must first incur the cost of obtaining the new collateral and then request liquidation of the appropriate amount from the progress payment fund before the requirements for attachment are satisfied.<sup>250</sup> It is readily apparent that the Government's security interest would attach much too late to prevail against these other creditors.

The same problem occurs when the Government perfects its security interest. Perfection is of course critical to establishing priorities among competing security interests and has special application in bankruptcy where perfected interests have priority over almost all other claims against the collateral in the estate. Since the progress payment property remains in the possession of the debtor, the Government would normally perfect its interest by filing a financing statement in accordance with the applicable state recording act.<sup>251</sup> The date the security interest is considered to be perfected is the later of the date the interest attached to the collateral and the date the financing statement was filed.<sup>252</sup> Since most lenders file the financing statement on the contractor's inventory before advancing funding, as soon as the contractor obtains any right to the inventory, the security interest is perfected. Thus, the Government will be faced with a previously perfected security interest before the progress payment security interest can even attach, let alone perfected.

As a result, the Government will not be able to obtain a superior security interest to creditors and financial institutions with previously perfected security interests in inventory and materials. Under these circumstances, the Government is left without adequate security for both its financial interest as well as sensitive defense procurements should the contractor become insolvent. Armed with only a lien or security interest, the Government faces a trying situation to say the least, under the Bankruptcy Code. In addition to the above mentioned difficulties in obtaining a superior perfected security interest under state law, even this interest might not be sufficient to ensure eventual Government possession of the progress payment property in bankruptcy. In a Chapter 11 reorganization, the Government must face potentially lengthy delay, and in the worst case, may also be required to accept some alternate collateral of the trustee's choosing in satisfaction of its progress payment security interest.<sup>253</sup> Under section 1129, the "cram down" provisions of the Bankruptcy Code, even a protesting secured creditor may eventually lose the specific collateral to which the security interest had attached. If the trustee also rejects the executory contract with the attendant duty to deliver the property, the Government as a secured creditor, may lose all control over the originally contracted for property.<sup>254</sup> While this appears in direct conflict with the rule that the Government is entitled to receive what it contracts for,<sup>255</sup> the policy behind the "cram down" provisions may bring about a contrary result. As previously noted,<sup>256</sup> Congressional policy has already demonstrated the intent to slowly reduce the Government to the status of just another creditor.

Also, the rule is one of sovereignty, and focuses upon state, not federal law, which interferes with the Government's possession. Because of the Congressional bankruptcy policy and the limited application of the Government's possession rule, differing judicial treatments of this issue are bound to occur. Since the Bankruptcy Code does not address the presently accepted title vesting provisions, further limitation of the Government's status should not originate in the courts. As previously indicated, unless numerous changes are effected in how progress payments are made, only title will continue to adequately secure the Government's interest against competing creditors.

#### IV PROPOSALS AND CONCLUSIONS

##### A. General Observations

A pragmatic review of the present relationship between bankruptcy and federal procurement disputes resolution indicates that there are many problems and few possible solutions. Any expectation that Congress will reverse its present policy trend in bankruptcy toward reducing the Government's previously favored status, is unrealistic. However, countervailing policy based on the public interest in efficient, effective, and responsible public procurement can co-exist with bankruptcy's egalitarian nature. The basic need at this time is statutory and regulatory clarifications which promote responsibility and efficiency, rather than purely pecuniary interests. Even in the latter interest, the Government is entitled to protection, although the exact degree to which the Government should be favored over the private creditor is uncertain. The following proposals are based on the general observation that there is a valid Government interest requiring such protection.

Before proposing legislative or regulatory relief, one must consider the hoary adage, if it ain't broke don't fix it. From the Government's perspective, bankruptcy has indeed "broken" the ability to terminate unsatisfactory contracts with the debtor; to recover progress payment property, unliquidated progress, and advance payments; and to obtain consistent treatment of claims under the provisions of the Contract Disputes Act. Some of these issues can be resolved to the Government's satisfaction by legislative or regulatory change, but the Government must accept the basic fact

that bankruptcy imposes some inescapable limitations.

#### B. Regulatory v. Legislative Approaches

As discussed, the Government can presently argue for the recovery of progress payment property under the title vesting theory; termination of unsatisfactory contracts under the Nonassignment Act; and claims valuation by the ASBCA under the Contract Disputes Act. Of the three, only the nonassignability argument is not widely accepted. However, efficient procurement management and equal treatment of contractors in bankruptcy requires consistency, a quality lacking in this area. Absent an unequivocal pronouncement from the U.S. Supreme Court, which is obviously unlikely in the foreseeable future, consistency can only be accomplished through statutory or regulatory clarification of the title vesting provisions of the FAR; the Contract Disputes Act jurisdictional sections; the scope of the Nonassignment Act; and the respective sections of the Bankruptcy Code.

Modification of the Bankruptcy Code is usually not a practical or feasible approach to a solution to the above problems. Since Congress has already declined to provide the Government priority in non-tax monetary claims, there is little chance that subsections 362(b)(4) and (5) will be expanded to generally encompass a national defense exception to the operation of the automatic stay.

However, bankruptcy provides the framework in which numerous other laws and regulations operate, and it is in these other areas that changes should be made. The Code does not attempt to spell out the details of each exception to the general rules of what is within

the estate or subject to the automatic stay. Rather, other statutes and regulations are incorporated to determine whether the Code will even apply to the subject property or interest. By modifying or clarifying non-bankruptcy provisions, the Government's rights can be protected without touching the Bankruptcy structure itself. As a practical matter, attempts to clarify pre-existing peripheral statutes or regulations will meet with less resistance than a frontal assault on the Bankruptcy Code.

For example, rather than attempting to carve out an exception for progress payment property from the Code's general broad rule on the scope of the estate, the Government's actual title to the property ownership should be clarified in the FAR title vesting provisions. While a change in the FAR is important for anyone dealing with government procurement, it would not have any impact on the vast majority of bankruptcy cases. In contrast, any attempt to specifically create such an exception in the Bankruptcy Code could be broadly interpreted as opening the floodgates for other special interests to carve out their own exceptions. Thus, while modification of the Bankruptcy Code appears at first glance to be the most straightforward method to protect the Government's interests, the realities of Congressional resistance to further proliferation of narrow exceptions set out in the Code, and the trend away from favoring the Government in bankruptcy makes this approach highly unlikely.

### C. Proposals and Insolvable Problems

#### 1. Termination of the Contract

As previously discussed, unless the Government can terminate an unsatisfactory contract with the debtor,

funds necessary for reprourement will remain obligated under the contract, and the Government will bear the excess costs of such a reprourement. Presently, the Government must rely on the incorporation of the Nonassignment Act by 11 U.S.C. §365(c)(1) to prevent assumption of the contract and allow termination. Clarification of the relationship between 11 U.S.C. §365(c)(1), and the Nonassignment Act would certainly serve to eliminate the inconsistent treatment these provisions are given by the courts. However, this is a problem which very possibly should not be taken back to Congress for a solution. While the better interpretation of these two provisions should except Government contracts from being currently assumed in bankruptcy, any attempt to clarify this position by amending the Nonassignment Act to specifically apply to the trustee and debtor in possession, may bring about an unpredictable and undesirable result.

## 2. Title to Progress Payment Property

The Government's ability to speedily recover progress payment property is an important factor in ensuring timely and efficient reprourement. Any interpretation of the title vesting clause which gives less than actual title to the Government is insufficient to satisfy this requirement. In order to avoid the confusion raised by Marine Midland and the lien interpretation of the title vesting provision, 10 U.S.C. §2307 and 41 U.S.C. §255 should be amended to specifically recognize title vesting as a means to protect the Government's interest in progress payment property. While this would clear away any doubt about the Government's title, Congressional statements

indicate a reluctance to deal legislatively with a title issue which can be dealt with by regulation. Recently, the Senate House Conference Committee had occasion in the 1988 Defense Authorization Act to consider the issue of title to special tooling and test equipment for which the contractor is reimbursed for the costs by the Government. The Committee indicated that the issue of Government title in the property should be resolved by regulation rather than by statute.<sup>254</sup> This indirect guidance would indicate that as a practical matter, the clarification of title vesting in progress payment property must come in the provisions of the FAR.

Under this approach, the general provisions of FAR 32.503-14 and the Progress Payments Clause at FAR 52.232-16 should be modified to state that the title transferred to the Government is an absolute title and not just a lien or security interest. For a suggested modification of the relevant subparagraph of the Progress Payment Clause, see Appendix 1. As modified, the contractual clause would operate to vest full title,<sup>255</sup> and allow the Government to seek relief from stay by the bankruptcy court in order to retrieve the progress payment property. The regulatory approach is also more feasible from the Government's perspective since it retains control over the reformation process and can expedite the results.

### 3. Forum Referral for Liquidation of Claims

Presently, both the Bankruptcy Code and the Contract Disputes Act purport to provide the exclusive mechanisms and fora for liquidation of claims when a government contractor has filed for bankruptcy

protection. The Government's interests can best be protected by ensuring that all claims arising out of a federal contract are processed under the statutory system which was specifically designed to provide consistent and efficient treatment of this specialized area of the law. Although liquidated claims are ultimately the province of the bankruptcy courts, contested unliquidated contractual claims should be the responsibility of the fora provided under the Contract Disputes Act. Rather than attempting to alter the bankruptcy court's general ability to defer to other fora for liquidation of claims, the Contract Disputes Act can be clarified to specifically address resolution of claims by or against a contractor in bankruptcy. Such a modification follows the present majority policy of deferral by dictating the necessary relationship and interplay between the Bankruptcy Code and the Disputes Act. By reserving such tasks to the federal legal and regulatory system with the greatest expertise in procurement law, the bankruptcy court is freed from unnecessary work. This ensures expeditious processing of the bankruptcy action, to the benefit of the Government and other creditors.

In conclusion, the current conflicts in enforcement of bankruptcy law and federal procurement remedies indicate the system is indeed "broken." Whether the specific problems discussed above will be resolved is uncertain to say the least. A valid Governmental concern is that any legislative interest in the area might result in a "solution" worse than the present problem. Accordingly, each proposal should be considered separately, the risks weighed, and the prevailing political winds tested before legislative reform is requested. The best approach may very well

be to litigate and accept inconsistency rather than an unfavorable statutory amendment. However, the Government should take those actions immediately available to protect its interests. These actions include more emphasis on aggressive measures by the contracting officer prior to the bankruptcy petition to terminate unsatisfactory contracts, and obtain physical possession of progress payment property when the situation calls for it. Additionally, the FAR provisions covering title vesting in progress payment property should be modified to reflect the current judicial majority position in progress payment title vesting.

1. See U.S. v. Tingley, 30 U.S. (5 Pet) 115 (1831); Van Brocklin v. Tennessee, 117 U.S. 151 (1886)

2. See Whitside v. U.S. 93 U.S. 389 (1875); This deference is not unlimited, however. See generally Lynch v. U.S. 292 U.S. 571 (1934); U.S. v. Standard Rice Co., 323 U.S. 106 (1944) (The Government is treated as a private individual when it enters the commercial, contracting field.)

3. In the Matter of Gary Aircraft Corp. 698 F.2d 775 (5th Cir. 1983) cert. denied, 464 U.S. 820 (1983)

4. The Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978), (codified as amended in scattered sections of 11 and 28 U.S.C.)

5. Supra note 3, at 779

6. Williams v. U.S. Fidelity & Guaranty Co., 236 U.S. 549, 554-555 (1915); See also Local Loan v. Hunt, 292 U.S. 234, 244 (1934)

7. H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 340 (1977)[hereinafter H.R. Rep. No. 95-595], reprinted in 1978 U.S. Code Cong. & Admin News 5963, 6296, 6297
8. Id. at 340, reprinted at 6297
9. Baird & Jackson, Corporate Reorganizations and the Treatment of Diverse Ownership Interests, 51 U. Chi. L. Rev. 97 (1984)
10. U.S. Const. , art. I, §8
11. Comment, Bankruptcy: Historical View, 59 Tul. L. Rev. 1160 (1985)
12. See Jaffke v. Dunham, 352 U.S. 280 (1957); Security Mortgage Co. v. Powers, 278 U.S. 149 (1956); In Re Madeline Marie Nursing Homes, 694 F.2d 433 (6th Cir. 1982); see generally, Note, Bankruptcy and the Limits of Federal Jurisdiction, 95 Harv. L. Rev. 730 (1982)
13. Id.
14. 11 U.S.C. §§101(4), (9) (1982)
15. Id. §101(14)
16. Erie R.R. v. Thompkins, 304 U.S. 64 (1938)
17. 11 U.S.C. §507 (1982)
18. D. Cowans, Bankruptcy Law and Practice §12.32 (3rd ed. 1986)
19. See U.S. v. Kimbell Foods, Inc. 440 U.S. 715, 732 n. 28 (1979); Marine Midland Bank v. U.S., 687 F.2d 395 (Ct.Cl. 1982), cert. denied, 460 U.S. 1037 (1983)
20. See First National Bank of Geneva v. U.S., 13 Cl.Ct. 385, 387 n.3 (1987); In re American Pouch Foods, Inc., 769 F.2d 1190 (7th Cir. 1985), cert. den., 475 U.S. 1082 (1986)

21. Act of July 1, 1898, Ch. 541, 30 Stat. 544 (repealed 1978)
22. U.S. Const. art. III, §1
23. Supra note 11, at 1168
24. S. Rep. No. 95-989, 95th Cong. 2d Sess. 16 (1978), [hereinafter S. Rep. No. 95-989], reprinted in 1978 U.S. Code Cong. & Admin. News 5788, 5789; H.R. Rep. No. 95-595, supra note 7, at 3,4, reprinted at 5965
25. H.R. Rep. No. 95-595, supra note 7, at 2, 3, reprinted at 5963, 5964
26. Supra note 4
27. 28 U.S.C. §§1471(a), (b) (1982)
28. H.R. Rep. No. 95-595, supra note 7, at 2, 3, reprinted at 5963, 5964
29. Northern Pipeline Construction Co. v. Marathon Pipeline Co., 458 U.S. 50 (1982) (Justice Brennan, writing for a plurality, held that the jurisdictional grant to the bankruptcy judges under 28 U.S.C. §1471 was an unconstitutional attempt by Congress to vest Article III jurisdiction in a non-Article III court-adjunct.)
30. Supra note 11, at 1170
31. D. Cowans, Bankruptcy Law and Practice, §1.2(d) (3rd ed. 1986)
32. 28 U.S.C. §§1334(a), (b) (West Supp. 1985)
33. Id. §151
34. Id. §157(a)

35. See generally Note, Bankruptcy and the Limits of Federal Jurisdiction, 95 Harv. L. Rev. 730 (1982); A broad, but nonexclusive, list of "core" proceedings are contained in 28 U.S.C. §157(b).

36. 28 U.S.C. §2075 (West Supp. 1985)

37. Bankruptcy Rules and Official Forms, August 1, 1983 (as amended 1987)

38. Id. Rules 7002-7071, 9017, 9029

39. Chapter 1 (General Provisions), Chapter 3 (Case Administration), Chapter 5 (Creditors, Debtors, and the Estate). The Bankruptcy Code is presently divided into eight chapters, using odd numbers with the exception of Chapter 12.

40. Chapter 7 (Liquidation), Chapter 9 (Adjustment of Debts of a Municipality), Chapter 11 (Reorganization), Chapter 12 (Adjustment of Debts of a Family Farmer with Regular Annual Income), and Chapter 13 (Adjustment of Debts of an Individual with Regular Income). Chapter 12 was added by P. L. 99-534, October 27, 1986.

41. H.R. Rep. No. 95-595, supra note 7, at 6, reprinted at 5967

42. While certain contracting may be done with an individual debtor who files under Chapter 13, the vast majority of cases involving a continuing business come under Chapter 11. Focus will accordingly be made on the reorganization provisions of Chapter 11.

43. 11 U.S.C. §726 (1982) (Distribution of Property of the Estate); §727 (Provides for discharge of claims against an individual debtor and debts against the estate)

44. Id. §§1102-1146

45. S. Rep. No. 95-989, supra note 26, at 3, reprinted at 5789
46. 11 U.S.C. §727(a)(1) (1982); S.Rep. No. 95-989, supra note 26, at 7, reprinted at 5793 ("A change from current law will prevent corporations from being discharged in liquidation cases. Corporations are not in the same situation as individual debtors, and the discharge of a corporation promotes trafficking in corporate shells, a form of bankruptcy fraud.")
47. Filing under one chapter may be converted however, under 11 U.S.C. §348 (1982)
48. Id. §721
49. Id. §704(1)
50. Id. §365(a)
51. Id. §§1107, 1108
52. Telephone interview with LTC Billy Smith, Jr., Trial Attorney, Contract Law Division, Office of the Judge Advocate General, U.S. Air Force (November 5, 1987)
53. 11 U.S.C. §§701-703 (1982)
54. Id. §1107 (Appointment of a trustee in a Chapter 11 reorganization is required only if special factors such as fraud are present or if the appointment is otherwise in the best interests of the creditors despite the extra costs involved.)
55. See In re Braniff Airways, Inc., 700 F.2d 935 (5th Cir. 1983); In re Pennsylvania Peer Review Org'n, Inc., 50 B.R. 640 (Bankr. 1985)
56. 11 U.S.C. §323 (1982)
57. Id. §541
58. Id. §542

59. Id. §543

60. In re Corporacion de Servicios Medicos Hospital, 805 F.2d 440, 444 n. 3 (1st Cir. 1986)

61. H.R. No. 95-595, supra note 7, at 367, reprinted at 6323

62. See H.R. rep. No. 95-595, supra note 7, at 347, reprinted at 6303, 6304. ("Though there is no precise definition of what contracts are executory, it generally includes contracts on which performance remains due to some extent on both sides. A note is not usually an executory contract if the only performance that remains is repayment. Performance on one side of the contract would have been completed and the contract is no longer executory."; see generally In re Alexander, 670 F.2d 885 (9th Cir. 1982); Countryman, Executory Contracts in Bankruptcy, Part I, 57 Minn. L. Rev. 439, 460 (1973)("[A] contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete the performance would constitute a material breach excusing the performance of the other."); Weintraub and Resnick, What is an Executory Contract? A Challenge to the Countryman Test, 15 U.C.C.L.J. 273, Winter 1983.

63. 11 U.S.C. §365(g) (1982)

64. Id. §362(a)

65. Id. §544

66. Id. §525(a); See In re Exquisito Services, Inc. 823 F.2d 151 (5th Cir. 1987)

67. See H.R. Rep. No. 95-595, supra note 7, at 340, 366, 367, 370, reprinted at 6296, 6297 [Discussion of §525(a) anti-discrimination provisions, In re Rees, 61 B.R. 114, 120, 121 (Bankr. D. Utah 1986)(collecting cases); In re The A.C. Williams Company, 51 B.R. 496, 500 (Bankr. N.D. Ohio 1985)(collecting cases); But see In re Exquisito Services, Inc. 823 F.2d 151, 153 (5th Cir. 1987);][Discussion of §362 automatic stay provisions, See In re Elsinore Shore Associates, 66 B.R. 723 (Bankr. D.N.J. 1986)

68. 11 U.S.C. §§362(b)(4), (5) (1982)

69. See In re Wellham, 53 B.R. 195, 197 (Bankr. 1985); In re Continental Airlines, 40 B.R. 299 (Bankr. 1984); In re I.D.H. Realty, Inc., 16 B.R. 55 (Bankr. 1981); Heckler Land Development v. Montgomery, 15 B.R. 856 (Bankr. 1981); In re King Memorial Hospital, Inc., 4 B.R. 55 (Bankr. 1981); Contra Penn. Terra Ltd. v. Department of Environmental Resources, 733 F.2d 267, 273 (3rd Cir. 1984)(§362(b)(4) should be construed as broadly as possible to allow states as much power as feasible under bankruptcy due to the general rule that federal preemption is not favored.)

70. In interpreting §365(b)(5), see N.L.R.B. v. Edward Cooper Painting, Inc., 804 F.2d 934, 943 (6th Cir. 1986); Penn Terra Limited v. Department of Environmental Resources, 733 F.2d 267, 275 (3rd Cir. 1984); In re Mansfield Tire & Rubber Co., 660 F.2d 1108, 1114, 1115 (6th Cir. 1981); In re Tauscher, 7 B.R. 918 (Bankr. E.D. Wis. 1981)

71. 11 U.S.C. §362(d)(1) (1982)

72. 11 U.S.C. §§401(1)-(13) (1982)

73. U.S. v. Corliss Steam Engine Co., 91 U.S. 321 (1875)
74. See Dusenbury Motors Corp. v. U.S., 260 U.S. 115, 121, 122 (1922)
75. See Dorris Motor Co. v. U.S., 271 U.S. 96 (1926)
76. Under the standard default clauses for fixed-price contracts, the Government is allowed to recover the excess procurement costs from the defaulting contractor in addition to any common law damages. FAR 52.249-8(b)
77. S.Rep. No. 93-692, 93rd Cong. (1974), reprinted in U.S. Code Cong. & Admin News 4590
78. Pub. L. 93-400, August 30, 1974, 88 Stat. 796, codified as 41 U.S.C. §401 et.seq.
79. The FAR is statutorily based on 41 U.S.C. §405(a), and reflects Executive Order No. 12352, March 17, 1983
80. FAR Chapter 49
81. FAR Chapter 32
82. FAR Chapter 33
83. FAR 52.249-8(h); However, many common law remedies have been partially codified. Setoff, for example, is a common law remedy available to the Government, see e.g. Gratiot v. U.S., 40 U.S.(15 Pet.) 336 (1841), U.S. v. Munsey Trust, Co., 332 U.S. 234 (1947), that is now statutorily available to the Comptroller General under the general grant of authority in 31 U.S.C. §3701 (1982).
84. FAR 49.502; 52.249-1; (The standard termination for convenience language allows the Contracting Officer the discretion to terminate a contract partially or completely if the action is in the Government's best

interests. Furthermore, even if a termination is determined to be improper, the contractor will receive breach damages, but not reinstatement of the contract.)

85. FAR 52.249-8(b); (The FAR also provides for conversion of an improper termination under the default clause to a termination for convenience. See Specialty Construction Co., ASBCA No. 21132, 78-2 BCA p13,348.)

86. FAR 32.104(a)

87. Id. subpart 32.3

88. Id. 32.102(a), 32.4

89. Id. 32.102(b), 32.5; (Progress payments are funds provided to the contractor based upon costs incurred for completed performance. In contrast, advance payments are true advances of funding before performance, to be liquidated as work progresses.)

90. FAR 52.232-16; see also subpart 32.502-4(a)

91. Id. 52.232-12; 32.411, 412 (For additional security measures concerning unliquidated progress payments, see FAR 32.501-5.)

92. FAR 33.201, 33.206

93. 41 U.S.C. §§601-613 (1982)

94. FAR 33.202, 33.203

95. S.Rep. No. 95-1118, 95th Congress [hereinafter S.Rep. No. 95-1118] at 1, reprinted in 1978 U.S. Code Cong. & Admin News 5235

96. Nash & Cibinic, Administration of Government Contracts, 891 (2d ed. 1985)

97. S.Rep. No. 95-1118, supra note 94, at 2, 3, reprinted at 5236, 5237

98. See McDonnell Douglas Corp. v. U.S., 754 F.2d 365 (C.A. Fed. 1985); Ingersoll-Rand Co. v. U.S., 780 F.2d 74 (D.C. Cir. 1985)

99. S. Rep. No. 95-1118, supra note 94, at 1, 2, reprinted at 5235, 5236; See also FAR 33.204

100. 41 U.S.C. §§607(a)(1), 609(a)(1) (1982); (The original designation as the Court of Claims was amended to the Claims Court by the Federal Courts Improvement Act of 1982, codified in part as 28 U.S.C. §1491)

101. 41 U.S.C. §605(a); See Space Engineering, Inc. ASBCA No. 26028, 82-1 BCA p15,766; (However, the Government and the contractor follow different procedures in making a claim. Some additional requirements on the contractor are found in FAR 33.206, 33.207.)

102. See Paragon Energy Corp. v. U.S., 645 F.2d 966 (Ct.Cl. 1981); Newell Clothing Co., ASBCA No. 24482, 80-2 BCA p14,774 (Jurisdiction of the Board is appellate only, in review of the contracting officer's final decision.)

103. 11 U.S.C. §605(c)(5) (Contracting officer's failure to provide a timely decision acts as a denial.)

104. 41 U.S.C. §605 (1982)

105. Id. §609(a)(1)

106. Id. §607(g)(1)(a)

107. 28 U.S.C. §1295(a)(3) (1982)

108. Under 31 U.S.C. §231, the Government has the right to sue in U.S. District Court to enforce its contractual rights. Direct suit on the contract is also available in state court. See U.S. v. Bank of New York & Trust Co., 296 U.S. 463, (1936); Cotton v. U.S.,

52 U.S.(11 How.) 229 (1850).

109. See e.g. Pub. L. 85-804, codified as 50 U.S.C. §§1431-1435 (1982); (The statute allows the contractor to seek extraordinary contractual relief such as reformation and rescission. Under FAR 33.205, the contractor must still present such a claim to the contracting officer for a final decision.)

110. Supra notes 57-70, and accompanying text

111. Historically, the Government has had some form of statutory priority when collecting a non-tax based debt, whether in bankruptcy or some other collective insolvency proceeding. Rev. Stat. §3466 (1875); 31 U.S.C. §191 (1964), amended by 31 U.S.C. §3466; However, under section 507 of the present Bankruptcy Code, the Government's unsecured non-tax claims have no priority, and are considered to be general unsecured claims. "The Government's general priority for non-tax claims, currently the fifth priority in section 64 of the Bankruptcy Act[of 1898], is abolished." S.Rep. No. 95-989, supra note 20, at 6, reprinted at 5792; "The time has past when the sovereign can do no wrong and is entitled to the first of every insolvent estate." H.R. Rep. No. 95-595, supra note 7, at 194, reprinted at 6154; See generally Plumb, The Federal Priority in Insolvency: Proposals for Reform, 70 Mich. L. R. 1, 3 (1971); Plumb, Federal Liens and Priorities-Agenda for the Next Decade, 77 Yale L. J. 228 (1967); Kennedy, The Relative Priority of the Federal Government: The Pernicious Career of the Inchoate and General Lien, 63 Yale L. J. 905 (1954)

112. Id.

113. Once federal funds are formally obligated to pay for the goods and services of the contract, any attempt to withdraw those funds without first terminating the Government's liability to perform under the contract will result in a violation of the Anti-Deficiency Act, 31 U.S.C. §§1349(a), 1350 (1982); Also, the Government's ability to recover excess procurement costs and certain liquidated damages is predicated upon a termination of the contract for default. FAR 12.202, 52-212.4, 52.249-8

114. Harris Products, Inc., ASBCA No. 30426, 87-2 BCA p19,807

115. One example is the trustee must cure or provide certain guarantees if the contract was in default at the time of the bankruptcy petition. see generally 11 U.S.C. §§365(b)-(m) (1982).

116. 11 U.S.C. §721 (1982)

117. Unlike other contracts which the trustee may assume and then assign for the benefit of the estate, under 41 U.S.C. §15 (1982), Government contracts may not be assigned to third parties over the Government's objection. When the trustee or debtor in possession is assuming the contract in order to continue performance, the application of the statute's prohibition has been contested. However, assumption under Chapter 7 solely to assign the contract further should be prohibited. For further discussion, see Chapter III(A)(3) below.

118. Supra note 62

119. 11 U.S.C. §365(g) (1982); The Government should still formally terminate the contract in addition to the action of the trustee. see In re Invader, 71 B.R. 564 (Bankr. W.D. Tex. 1987)

120. See In re Record, 8 B.R. 57 (Bankr. S.D. Ind. 1980); This view is in accord with the legislative history which uses the example of a note not being an executory contract since no further performance is due by one party. H.R. Rep. No. 95-595, supra note 7, at 347, reprinted at 6303, 6304

121. 11 U.S.C. §365(b)(1) (1982); The duty to promptly cure has been interpreted as a higher standard than simply "within a reasonable time." General Motors Acceptance Corp. v. Lawrence, 11 B.R. 44 (Bankr N.D. Ga. 1981); What constitutes adequate assurance of cure and performance is once again left undefined by the Code despite the examples given in 11 U.S.C. §361 (1982). The determination is made on a case-by-case basis, loosely patterned after the language in Uniform Commercial Code §2-609(1), "When reasonable grounds for insecurity arise with respect to the performance of either party the other may in writing demand adequate assurance of due performance and until he receives such assurance may if commercially reasonable suspend any performance for which he has not already received the agreed return." See In re Sapolin Paints, Inc. 5 B.R. 412 (Bankr. E.D. N.Y. 1980)

122. FAR 9.103 reads in part:

(b) No purchase or award shall be made unless the contracting officer makes an affirmative determination of responsibility.

123. FAR 9.104-1 General Standards, reads in part:

To be determined responsible, a prospective contractor must-

(a) Have adequate financial resources to perform the contract, or the ability to obtain them...;

(b) Be able to comply with the required or proposed delivery or performance schedule, taking into consideration all existing commercial and governmental business commitments;

(c) Have a satisfactory performance record...;

(d) Have a satisfactory record of integrity and business ethics;

(e) Have the necessary organization, experience, accounting and operational controls, and technical skills, or the ability to obtain them (including, as appropriate, such elements as production control procedures, property control systems, and quality assurance measures applicable to materials to be produced or services to be performed by the prospective contractor...);

(f) Have the necessary production, construction, and technical equipment and facilities, or the ability to obtain them...; and

(g) Be otherwise qualified and eligible to receive an award under applicable laws and regulations.

124. 11 U.S.C. §362(b)(4) (1982)

125. H.R. Rep. No. 95-595, supra note 7, at 343, reprinted at 6299

126. Supra note 69 and accompanying text

127. See State of Missouri v. U.S. Bankruptcy Court, 647 F.2d 768, 776 (8th Cir. 1981), cert. denied, 454 U.S. 1162 (1981) (The court stated that §362(b)(4) did not encompass exercise of "regulatory laws that directly conflict with the control of the res by the bankruptcy court."

128. See In re Corporacion de Servicios Medicos Hospital, 805 F.2d 440, (1st Cir. 1986)

129. In re Lawson Burich Associates, 31 B.R. 604 (D.C. S.D. N.Y. 1986)

130. See N.L.R.B. v. Edward Cooper Painting, Inc., 804 F.2d 934, 942 (6th Cir. 1986)(collecting cases); In re Wellham, 53 B.R. 195, 197 (Bankr. 1985)(collecting cases); In re Herr, 28 B.R. 465, 468 (Bankr. D. Me. 1983)(collecting cases)

131. See In re Charter First Mortgage, Inc. 42 B.R. 380, 382 (Bankr. Or. 1984), In Charter, the court stated "In reviewing the cases, it is clear to this court that in applying the pecuniary purpose test, it must first look to what specific acts the government wishes to carry out and determine if such advantage would result in an economic advantage to the government or its citizens over third parties in relation to the debtor's estate." See also, Swan v. Devros, 37 B.R. 731, 734 (Bankr. N.D. Ill. 1984); In re Thomassen, 15 B.R. 907, 909 (9th Cir. 1981), "[S]tate and local government units cannot, by the exercise of their policy or regulatory powers, subvert the relief afforded by the federal bankruptcy laws. When they seek to do so for a pecuniary purpose, they are automatically stayed..." Thomassen at 909

132. See In re Herr, 28 B.R. 465, 468 (Bankr. D. Me. 1983) "This test distinguishes between proceedings that effectuate public policy and those that adjudicate private rights: only the former are excepted from the automatic stay." Herr at 468; In re Wellham, 53 B.R. 195, 197 (Bankr. M.D. Tenn. 1985) The court said the question was whether the government was "engaging in an action which affects the immediate parties to the

action or whether it concerns a wider group subject to the authority of the government unit." Wellham at 197

133. See N.L.R.B. v. Edward Cooper Painting, Inc. 804 F.2d 934 (6th Cir. 1986); Ahrens Aircraft, Inc., 703 F.2d 23 (1st Cir. 1983); N.L.R.B. v. Evans Plumbing Co., 639 F.2d 291 (5th Cir. 1981)

134. See e.g. E.E.O.C. v. Hall's Motor Transport Co., 789 F.2d 1011 (3rd Cir. 1986) (Employment discrimination hearing allowed to proceed); In re Valley Kitchens, Inc. 68 B.R. 373 (Bankr. S.D. Ohio 1986) (Sexual discrimination hearing allowed to proceed); In re Bennett Paper Corp., 63 B.R. 8 (Bankr. E.D. Mo. 1985) (Employment discrimination hearing allowed to proceed)

135. See e.g. In re Commonwealth Oil Refining Co., 805 F.2d 1175 (5th Cir. 1986) cert. denied, 107 S. Ct. 3228 (1987); U.S. v. Jones & Laughlin Steel Corp., 804 F.2d 348 (6th Cir. 1986)

136. See In re Wellham, 53 B.R. 195 (Bankr. M.D. Tenn. 1985); see also In re Ellis, 66 B.R. 821 (Bankr. N.D. Ill. 1986) (State agency action to recover payments fraudulently obtained was not within the automatic stay exception despite potential to deter future fraud, since the actual fraud had been committed 3 years earlier.)

137. Supra note 124, and accompanying text; See U.S. v. Dept. of Housing and Urban Development v. Sutton, 68 B.R. 89 (Bankr. E.D. Mo. 1986); In re Liss, 59 B.R. 556 (Bankr. N.D. Ill. 1986); In re Charter First Mortgage, Inc., 42 B.R. 380 (Bankr. D.C. Or. 1984)

138. FAR 9.403 reads in part:

"Debarment," as used in this subpart, means action taken by a debarring official under 9.406 to exclude a contractor from Government contracting and Government-approved Subcontracting for a reasonable, specified period; a contractor so excluded is "debarred."...

"Suspension," as used in this subpart, means action taken by a suspending official under 9.407 to disqualify a contractor temporarily from Government contracting and Government-approved subcontracting; a contractor so disqualified is "suspended."

139. FAR 9.402(a)

140. See e.g. Janik Paving & Construction, Inc. v. Brock, 828 F.2d 84, 89-92 (2nd Cir. 1987) (Debarment is a proper means to enforce compliance with labor laws under CWHSSA); Gonzalez v. Freeman, 334 F.2d 570, 576, 577 (D.C. Cir. 1964) (Debarment upheld as a necessary method to ensure successful implementation of surplus commodity program by Commodity Credit Corporation); Copper Plumbing & Heating Co. v. Campbell, 290 F.2d 368 (D.C. Cir. 1961) (Debarment authority upheld as necessary to ensure responsible bidding on government contracts under labor laws)

141. FAR 9.402(b); see e.g. Gonzalez v. Freeman, 334 F.2d 570, 576, 577 (D.C. Cir. 1964), quoting Copper Plumbing & Heating Co. v. Campbell, 290 F.2d 368, 372 (D.C. Cir. 1961), "Notwithstanding its severe impact upon a contractor, debarment is not intended to punish but is a necessary 'means for accomplishing the congressional purpose' of Commodity Credit..."; Janik

Paving & Construction, Inc. v. Brock, 828 F.2d 84, 91 (2nd Cir. 1987) "That...debarment may incidentally punish while it deters a statutory violation does not transform it into a purely punitive sanction...[I]f the sanction serves to compel compliance with the statute's substantive goals, then it should not be deemed a 'penalty.'"

142. A possible exception to this rule may occur if the debarment is determined to be a means of punishing the contractor regardless of the present responsibility. See generally The Nash & Cibinic Report, Vol. 1, No. 12 p90 (Dec. 1987); The Government Contractor, Vol. 27, No. 6, 79 (Mar. 1985); Since punishment per se, does not comport with the FAR's stated policy reasons, the bankruptcy court may do equity and deny exception to the automatic stay in these circumstances. This should be contrasted with actions under statutes such as the False Claims Act, where at least one court has held that an action to punish a fraudulent contractor was within subsection 362(b)(4). see In re Herr, 28 B.R. 465 (Bankr. 1983)

143. FAR 9.405-1 provides:

(a) Notwithstanding the debarment or suspension of a contractor, agencies may continue contracts or subcontracts in existence at the time the contractor was debarred or suspended, unless the acquiring agency's head or a designee directs otherwise. A decision as to the type of termination action, if any, to be taken should be made only after review by agency contracting and technical personnel and by counsel to ensure the propriety of the proposed action.

(b) Agencies shall not renew current contracts or

subcontracts of debarred or suspended contractors, or otherwise extend their duration, unless the acquiring agency's head or a designee states in writing the compelling reasons for renewal or extension.

It is doubtful that a bankruptcy court would allow an executory contract otherwise necessary to reorganization to be terminated pursuant to debarment. See c.f. In re Corporacion de Servicios Medicos Hosp. 805 F.2d 440, 444-447 (1st Cir. 1986) (The court refused to allow the Government to terminate debtor's contract in part because the contract was the only asset, and to remove it would force the debtor from reorganization to liquidation under Chapter 7.) In the most serious situations which merit immediate termination of present contracts, the Government could argue that the public interest absolutely requires such protection despite the impact on the debtor's estate. Subsection 362(b)(5) does not prevent all governmental action which might have monetary impact on the debtor. see e.g. In re Lenz Oil Service, Inc. 65 B.R. 292 (Bankr. N.D. Ill. 1986) (In interpreting what is allowed by §362(b)(5), not every judgement which by its operation forces the debtor to spend money is actually a prohibited monetary judgement.); In re Wheeling-Pittsburg Steel Corp., 63 B.R. 641 (Bankr. W.D. Penn. 1986) (A back-to-work order was enforced although the debtor could lose enough by paying wages to endanger the prospective reorganization.)

144. See Perkins v. Lukens Steel Co., 310 U.S. 113 (1940); While debarment for fraud or other dishonesty raises a constitutional liberty interest, no property interest vests. See e.g. Gonzalez v. Freeman, 334 F.2d

570, 574 (D.C. Cir. 1964); ATL Inc. v. U.S., 736 F.2d 677 (Fed. Cir. 1984)

145. 11 U.S.C. §365 (1982)

146. 11 U.S.C. §365(c) (1982) provides in part:

(c) The trustee may not assume or assign any executory contract...of the debtor, whether or not such contract...prohibits or restricts assignment of rights or delegation of duties, if--

(1)(A) applicable law excuses a party, other than the debtor, to such a contract...from accepting performance from or rendering performance to an entity other than the debtor or debtor in possession, whether or not such contract...prohibits or restricts assignment of rights or delegation of duties; and

(B) such party does not consent to such assumption or assignment; or

(2) such contract is a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor...

147. See In re Adana Mortgage Banker, Inc. 12 B.R. 977, 987, 988 (Bankr. N.D. Ga. 1980); 11 U.S.C. §362(d) (1982) provides in part:

(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay--

(1) for cause, including the lack of adequate protection of an interest in property of such

party in interest...

148. In re Taylor Manufacturing, 6 B.R. 371 (Bankr. N.D. Ga. 1980); In Taylor, the court relied upon the meager legislative history of the drafter's intent, quoting at 372 n.2, "Second, executory contracts requiring the debtor to perform duties nondelegable under applicable nonbankruptcy law should not be subject to assumption against the interest of the nondebtor party." Commission Report, H.R. Doc. No. 93-137, 93rd Cong., 1st Sess. (1973), p. 199 The court also looked to Collier on Bankruptcy, (15d ed. 1980), which indicated that §365(c) should be limited in application to personal services or confidential types of contracts. See also Matter of Fulton Air Service, Inc., 34 B.R. 568 (Bankr. N.D. Ga. 1983); In re Haffner's 5 Cent to \$1.00 Stores, Inc., 26 B.R. 948 (Bankr. N.D. Ind. 1983); In re Bronx-Westchester Mack Corp., 20 B.R. 139 (Bankr. S.D. N.Y. 1982); In re U. L. Radio Corp., 19 B.R. 537 (Bankr. S.D. N.Y. 1981); In re Boogaart of Fla., Inc., 17 B.R. 480 (Bankr. S.D. Fla. 1981); In re Varisco, 16 B.R. 634 (Bankr. M.D. Fla. 1981)

149. See Taylor at 371, 372; The court indicated that under the rules of statutory construction, subsection (f) was the general rule and subsection (c) was the exception. The trustee could assume an executory contract despite applicable law to the contrary so long as the narrower subsection (c) did not apply. Subsection (c) was limited to prevent assumption of the relatively few traditionally nondelegable contracts in the personal services area. 11 U.S.C. §365(f) (1982) provides in part:

(f)(1) Except as provided in subsection (c) of this section, notwithstanding a provision in an executory contract...of the debtor, or in applicable law, that prohibits, restricts, or conditions the assignment of such contract..., the trustee may assign such contract or lease under paragraph (2) of this subsection.

(2) The trustee may assign an executory contract...of the debtor only if--

(A) the trustee assumes such contract...in accordance with the provisions of this section; and

(B) adequate assurance of future performance by the assignee of such contract...is provided...

In Fulton, the court expanded upon this argument, saying that construing subsection (c) broadly would render subsection (f) meaningless. Great emphasis was put on the use of different language in subsections (c) and (f) in referring to "applicable law." While subsection (c) refers to laws excusing performance, (f) alludes to laws prohibiting assignment. The court concluded the drafters must have intended this distinction to mean the two subsections were referring to different types of laws.

150. See In re Pioneer Ford Sales, Inc. 729 F.2d 27 (1st Cir. 1984); In re Nitec Paper Corp., 43 B.R. 492 (D.C.1984); Both cases indicated that no real conflict existed between the provisions of §§365(c)(1) and (f)(1). In Nitec at 498, the court stated that §365(f)(1) was designed to allow the trustee to override contractual provisions which attempted to bar assignment of the contract "even if 'applicable law' in

the state gives legal force to contractual provisions barring assignment." Nitec rejected any reading of subsection (f)(1) which would let the trustee make an assignment despite specific state or federal statutory prohibitions. This view was reinforced in Pioneer at 29, which explained the subsection (c)(1) referred to applicable anti-assignment laws "whether or not" they are mentioned in the contract, while subsection (f)(1) is silent on this language. The court concluded that the exclusion of the "whether or not" language meant that subsection (f)(1) dealt only with laws which enforced anti-assignment provisions in the contract. Such provisions would be struck down just as the Code does to contractual provisions which purport to allow the termination of a contract if a party files a petition in bankruptcy. The court went on to question Taylor's cognitive leap from the "conflict" to a conclusion that subsection (c)(1) was limited to personal services types of contracts, especially when Congress could have incorporated this into the statute so easily and did not.

151. In re Braniff Airways, Inc., 700 F.2d 935, 943 (5th Cir. 1983); Although the pre-Code rule which disallowed assignment of personal services contracts in bankruptcy may have been a starting point for §365(c), "the drafters actually codified a much broader principle." Braniff at 943 The court also pointed out that Congress would not have used such a broad term as "applicable law" if the intent was to limit the rule to personal service contracts. Under this rule, the trustee was not allowed to assume airport leases due to the provisions of The Washington Airport Act, 7 D.C. Code §§1101-1107, and 14 C.F.R. §159.91(a).

152. See In re Pioneer Ford Sales, Inc., 729 F.2d 27, 29 (1st Cir. 1984); The legislative history of §365(c) encourages a broad interpretation, rather than Taylor's restrictive application, of what applicable laws will prohibit assignment.

153. 41 U.S.C. §15 (1982) provides in part:

No contract or order, or any interest therein , shall be transferred by the party to whom such contract or order is given to any other party, and any such transfer shall cause the annulment of the contract or order transferred, so far as the United States are concerned. All rights of actions, however, for any breach of such contract by the contracting parties, are reserved to the United States.

154. See Hobbs v. McLean, Iowa, 117 U.S. 567 (1886); Thompson v. Commissioner of I.R.S., 205 F.2d 73 (3rd Cir. 1953)

155. See Chemical Recovery Co. v. U.S., 103 F. Supp. 1012 (Ct.Cl. 1952)

156. See In re Adana Mortgage Bankers, Inc., 12 B.R. 977 (Bankr. N.D. Ga. 1980); The Government National Mortgage Association was entitled under the Nonassignment Act and the National Housing Act to refuse to allow the debtor in possession to assume guaranty contracts.

157. Id. at 984

158. See Thompson v. Commissioner of the I.R.S., 205 F.2d 73 (3rd Cir. 1953); see also supra note 154, at 984, 985: Many of the factors the court enumerates in Adana to justify application of the Nonassignment Act to the GNMA contracts are also present in the federal

procurement area. These factors include the need for integrity, capability, and financial and managerial stability. The selection of federal contractors also focuses on responsibility as a prerequisite to the award of any procurement contract. Just as the integrity of the GNMA system and ultimately the federal Government was involved in Adana, the integrity of the procurement system depends on the Government's ability to select responsible contractors. Due to the enormity of the system, the Government must rely on the contractors' integrity and ability for the continued stability needed for successful accomplishment of the procurement mission.

159. See In re Pennsylvania Peer Review Org'n, Inc., 50 B.R. 640, 645, 646 n.7 (Bankr. M.D. Penn. 1985)

160. Id.; c.f. In re Pioneer Ford Sales, Inc. 729 F.2d 27 (1st Cir. 1984)

161. Supra note 156, at 986.

162. See In re United Press International, Inc. 55 B.R. 63 (Bankr. D.C. 1985)

163. FAR 32.3

164. FAR 32.4

165. FAR 32.5

166. While the Bankruptcy Code and its legislative history are not clear on what financing includes (see supra note 146), clearly, government contract provisions which incorporate financing and loan guarantees must enhance the debtor's financial situation. This forced enhancement of a debtor is what the section was designed to avoid. H.R. Rep. No. 95-595, supra note 7, at 348, reprinted at 6304

167. Subsection (c)(1)(A) was amended by P. L. 98-353, 98 Stat. 361, (1984), to refer to applicable laws excusing acceptance of performance by entities other than the debtor or the debtor in possession. Subsection (c)(2) is not limited in this fashion. As a result, §365(c)(2) should extend to block assumptions by debtors in possession. For prior case history, see e.g. In re New Town Mall, 17 B.R. 326 (Bankr. S.D. 1982); supra note 148, at 986.

168. See supra notes 66, 67 and accompanying text

169. 11 U.S.C. §525 (1982) reads in part:

(a)[A] governmental unit may not deny, revoke, suspend, or refuse to renew a license, permit, charter, franchise, or other similar grant to,...deny employment to, terminate employment of, or discriminate with respect to employment against, a person that is or has been a debtor under this title...

170. FAR 17.201 reads in part:

"Option" means a unilateral right in a contract by which, for a specified time, the Government may elect...to extend the term of the contract.

171. See e.g. American Bank Note Company, B-222589, 86-2 CPD p316; Brunswick Corporation, B-223577, 86-2 CPD p308; Industrial Maintenance Services, Inc., B-223300, 86-1 CPD p588; (All three cases holding that absent a real showing of fraud, bad faith, or complete ignorance of the responsibility criteria, the contracting officer's determination of nonresponsibility will not be questioned.)

172. In re Exquisito Services, Inc., 823 F.2d 151, 153 (5th Cir. 1987)(collecting cases); see also e.g. In re Goldrich, 771 F.2d 28 (2nd Cir. 1985); Duffey v.

Dollison, 734 F.2d 265 (6th Cir. 1984)

173. See In re Exquisito Services, Inc., 823 F.2d 151, 153 (5th Cir. 1987)

174. See e.g. In re Rees, 61 B.R. 114, 122 (Bankr. Utah 1986)

175. Supra note 123

176. See e.g. In re Coleman Am. Moving Services, Inc., 8 B.R. 379 (Bankr. Kan. 1980) (An Air Force contracting officer's nonresponsibility determination was in violation of subsection 525(a) because the decision focused upon the debtor's status under Chapter 11.); Matter of Son-Shine Grading, Inc., 27 B.R. 693 (Bankr. E.D. N.C. 1983) (State transportation department decision to remove debtor from a prequalified bidders list due to Chapter 11 reorganization violated subsection 525(a).); Matter of Marine Electric Railway Products Div., Inc., 17 B.R. 845 (Bankr. E.D. N.Y. 1982) (N.Y. City transit authority rejection of bid solely because of debtor in possession status under Chapter 11 prohibited by §525.)

177. See e.g. Matter of Marine Electric Railway Products Div., Inc., 17 B.R. 845, 851-853 (Bankr. E.D. N.Y. 1982); In re Coleman Am. Moving Services, Inc., 8 B.R. 379, 383 (Bankr. Kan. 1980)

178. S.Rep. No. 95-989, supra note 20, at 81, reprinted at 5867

179. H.R. Rep. No. 95-595, supra note 7, at 165, reprinted at 6126

180. In re Exquisito Services, Inc. 823 F.2d 151, 154 (5th Cir. 1987)

181. Id. at 155

182. Nathanson v. National Labor Relations Board, 344 U.S. 25 (1952); see also Gardner v. New Jersey, 329 U.S. 565 (1947); The liquidation of claims is a "core" proceeding under 28 U.S.C. §157(b), to which the bankruptcy court has exclusive jurisdiction. Although the court may defer to an administrative forum for liquidation of contingent claims, this should not be confused with the court's ability to abstain from hearing a case based on comity with a state court. See 28 U.S.C. §1334(c)(1). Deferment for liquidation is not a similar relinquishment of jurisdiction.

183. See Zimmerman v. Continental Air Lines, Inc., 712 F.2d 55, 56 (3rd. Cir. 1983), cert. denied, 464 U.S. 1038 (1984); In re Continental Airlines Corp., 64 B.R. 882, 886 (Bankr. S.D. Tex. 1986)

184. Matter of Gary Aircraft, Corp., 698 F.2d 775 (5th Cir. 1983), cert. denied, 464 U.S. 820 (1983); Prior to the Contract Disputes Act, contractor's claims were governed by the Disputes Clause which required the claim to pass through the contracting officer, and the agency's board of contract appeals prior to suit in the Court of Claims. This exclusive scheme was contrasted with the Bankruptcy Act which provided exclusive jurisdiction over cases in bankruptcy. Two previous cases that had accepted deferral to the ASBCA were U.S. v. Digital Products, Corp., 624 F.2d 690 (5th Cir. 1980) (Resolution of claims based on termination for default should go to ASBCA.) and In re Verco Industries, 27 B.R. 615 (Bankr. App. 9th Cir. 1982) (Lower court had deferred issues arising from the termination for default to the ASBCA.)

185. Id. at 783, 784

186. Id. at 784, n. 6;

187. See e.g. Zimmerman v. Continental Airlines, Inc., 712 F.2d 55 (3rd Cir. 1983), cert denied, 464 U.S. 1038 (1984) (In balancing two federal schemes, since bankruptcy can vindicate the purpose of the Arbitration Act, mandatory arbitration proceedings will be stayed.); In re McLean Industries, Inc., 76 B.R. 852 (Bankr. S.D. N.Y. 1987) (Since the issue involved was not esoteric, and within the province of the bankruptcy court, no lifting of stay for admiralty proceeding.); In re Amalgamated Foods, Inc., 41 B.R. 616 (Bankr. C.D. Cal. 1984) (Arbitration procedures under ERISA rejected since bankruptcy was an adequate if not better method to accomplish the statute's purposes because no specialized knowledge was required, Gary Aircraft inapplicable.); In re Compton Corp., 40 B.R. 880 (Bankr. N.D. Tex. 1984) (DOE proceeding to recover overcharges stayed since not so specialized that bankruptcy proceeding could not properly resolve the claim amounts.)

188. See e.g. In re Invader Corp., 71 B.R. 564 (Bankr. W.D. Tex. 1987) (Liquidation of costs surrounding termination for default of Navy contractor would be deferred to the ASBCA.); In re Meisner Industries, Inc., 54 B.R. 89 (Bankr. M.D. Fla. 1985) (Contractor's claim for progress payment deferred to ASBCA.); In re Economy Cab and Tool Co., Inc., 47 B.R. 708 (Bankr. Minn. 1985) (Contractor's claim for unpaid progress payment deferred to the administrative appeal process.); In re American Pouch Foods, Inc., 30 B.R. 1015 (D.C. Ill. 1983) aff'd 769 F.2d 1190 (7th Cir. 1985); In re Vogue Instruments, Corp., 31 B.R. 87 (Bankr. E.D. N.Y. 1983) (Debtor's action in bankruptcy court contesting termination for default stayed, until resolution by ASBCA.)

189. Previous cases such as Gary Aircraft, restricted the deferment to the Board of Contract Appeal since prior to the Contract Disputes Act, exhaustion of the Board appeal was required before appeal was allowed to the Court of Claims.

190. See supra notes 101-107, and accompanying text

191. 28 U.S.C. §§1334(a), (b), 157(a), (b); See e.g. In re Invader Corp., 71 B.R. 564, 567 (Bankr. W.D. Tex. 1987); In re Vogue Instruments, Corp., 31 B.R. 87, 90 (Bankr. E.D. N.Y. 1983); Although other courts do not specifically discuss jurisdiction, the existence of jurisdiction must be assumed, or there would be no discretion to exercise in deferring to the ASBCA. Also, other courts, including Gary Aircraft, may discuss deferment as required by law in this area, but this rule is always qualified by the statement that there be no countervailing considerations, or that the deferment may not cause undue delay. In such cases, the court could proceed under 11 U.S.C. §503(c) without deferment to the ASBCA. see e.g. Gary Aircraft 784, n. 7; In re Meisner Industries, Inc., 54 B.R. 89 (Bankr. M.D. Fla. 1985); While it is arguable that the enactment of the exclusive jurisdictional provisions of the Bankruptcy Code and the Contract Disputes Act during the same year indicated an intent that each should not interfere with the other's special area, the present bankruptcy courts apparently disagree. However, bankruptcy courts must bear in mind the requirement to exercise sound discretion in deferring to another administrative system established by Congress. see e.g. Nathanson v. N.L.R.B. 344 U.S. 25 (1952) (Bankruptcy court should defer to the N.L.R.B. for liquidation of unfair labor practice claims.);

Order of Railway Conductors v. Pitney, 326 U.S. 561 (1946) (Bankruptcy court should defer to Railway Labor Adjustment Board on union dispute in railway reorganization.)

192. 11 U.S.C. §365(b)(5) (1982); see In re Sam Daily Realty, Inc. 57 B.R. 83 (Bankr D.C. Haw. 1985)

193. 11 U.S.C. §541(a) (1982)

194. See e.g. In re American Pouch Foods, Inc. 769 F.2d 1190 (7th Cir. 1985) cert. denied, 474 U.S. 1082 (1986)

195. 11 U.S.C. §544(a) (1982) gives the trustee the rights of a hypothetical creditor with a judicial lien against the debtor's property as of the filing of the bankruptcy petition. The trustee will utilize this superior lien position to prevent the lien creditor from taking immediate possession of the property.

196. Supra notes 86-89, and accompanying text

197. The Progress Payments Clause, FAR 52.232-16 provides in part:

(d)(1) Title to the property described in this paragraph (d) shall vest in the Government. Vestiture shall be immediately upon the date of this contract, for property acquired or produced before that date. Otherwise, vestiture shall occur when the property is or should have been allocable or properly chargeable to this contract.

(2) "Property," as used in this clause, includes all of the below-described items acquired or produced by the Contractor that are or should be allocable to this contract under sound and generally accepted accounting principles and practices.

(i) Parts, materials, inventories, and work in

progress;

(ii) Special tooling and special test equipment to which the Government is to acquire title under any other clause of this contract;

(iii) Nondurable (i.e., noncapital) tools, jigs, dies, fixtures, molds patterns, taps gauges, test equipment, and other similar manufacturing aids, title to which would not be obtained as special tooling under subparagraph (ii) above; and

(iv) Drawings and technical data, to the extent the Contractor or subcontractors are required to deliver then to the Government by other clauses of this contract.

See also 41 U.S.C. §255;

The above provision should be compared to the Construction Progress Payment Clause, 52.232-5, which reads in part:

(d) All material and work covered by progress payments made shall, at the time of payment, become the sole property of the Government,...[emphasis added]

One commentator has pointed out that although this interest is less than provided by 52.232-16(d)(1), that the end result is usually the same since liens may not attach to materials incorporated into, and work done on Government real property. This negates the importance of whether payment has been made. See The Nash & Cibinic Report, Vol. 2, No. 1, p5 (Jan. 1988)

198. See e.g. Marine Midland Bank v. U.S., 687 F.2d 395 (Ct.Cl. 1982), cert. denied, 460 U.S. 1037 (1983)

199. See In re American Pouch Foods, Inc., 769 F.2d 1190, 1193 (7th Cir. 1985), cert. denied, 474 U.S. 1082 (1986)

200. Id. at 1193; Marine Midland Bank v. U.S., 687 F.2d 395, 401 (Ct.Cl. 1982), cert. denied, 460 U.S. 1037 (1983); (In order to escape statutory limitations, the title vesting provisions had to be strictly construed to transfer title to the Government.)

201. Armed Services Procurement Act of 1947, Pub. L. 80-65, 62 Stat. 21. (Advance payments were authorized for negotiated military procurement contracts.); Federal Property and Administrative Services Act of 1949, Pub. L. 81-288, 63 Stat. 377 (Advance payments were authorized for nonmilitary negotiated procurements.)

202. Pub. L. No. 85-800 §9, 72 Stat. 967, (1958), codified as 10 U.S.C. §2307; §2307(a)(1) and (c) read in part:

(a) The head of any agency may--

(1) make advance, partial, progress, or other payments under contracts for property or services made by the agency;...

(c) Advance payments under subsection (c) of this section may be made only upon adequate security and a determination by the agency head that to do so would be in the public interest. Such security may be in the form of a lien in favor of the Government on the property contracted for, on the balance in an account in which such payments are deposited, and on such of the property acquired for performance of the contract as the parties may agree. This lien shall be paramount to all other liens.

See also 41 U.S.C. §255

203. U.S. v. Ansonia Brass & Copper Co., 218 U.S. 452 (1910)

204. Id. at 466, 467

205. U.S. v. Allegheny County, 322 U.S. 174 (1944)

206. Id. at 183

207. E.g. City of Detroit v. Murray, 355 U.S. 489 (1958); (While the issue was the validity of a local tax on Government property, the title vesting clause was sufficient to vest title in the Government.); However, title vesting provisions did not go uncriticized. e.g. McClelland, The Illegality of Progress Payments as a Means of Financing Government Contractors, 33 Notre Dame L. Rev. 380 (1958)

208. 32 C.F.R. Part 82, subpart E (February 9, 1957)

209. Supra note 202

210. 1958 U.S. Code Cong. & Admin News 4031

211. In re American Pouch Foods, Inc., 769 F.2d 1190, 1194, 1195 (7th Cir. 1985), cert. denied, 475 U.S. 1082 (1986)

212. See e.g. In re Wincom Corp., 76 B.R. 1,2 (Bankr. Mass. 1987); In re Economy Cab and Tool Co., Inc., 47 B.R. 708, 711 (Bankr. Minn. 1985)

213. Marine Midland Bank v. U.S., 687 F.2d 395 (Ct.Cl. 1985), cert. denied, 460 U.S. 1037 (1983)

214. See Welco Industries, Inc. v. U.S., 8 Cl.Ct. 303 (1985), aff'd., 790 F.2d. 90 (Fed. Cir. 1986); First National Bank of Geneva v. U.S., 13 Cl.Ct. 385 (1987)

215. See e.g. In re American Pouch Foods, Inc. 769 F.2d 1190 (7th Cir. 1985), cert. denied, 475 U.S. 1082 (1986); In re Reynolds Manufacturing Co., 68 B.R. 219

(Bankr. W.D. Penn. 1986); In re Economy Cab & Tool Co., 47 B.R. 708 (Bankr. Minn. 1985)

216. See In re Wincom, 76 B.R. 1,3,4 (Bankr. Mass. 1987)

217. See First National Bank of Geneva v. U.S., 13 Cl.Ct. 385 (1987); "As a court with nationwide jurisdiction, it is in the interest of public policy that the law be applied consistently. The court is uneasy with the thought that two plaintiffs will be treated differently under the law merely because one litigates in the bankruptcy courts and one litigates in the United States Claims Court. This court would be inclined to adopt the reasoning of the title theory, but is not in a position to do so." Geneva at 387, n.3

218. See Marine Midland Bank v. U.S., 687 F.2d 395, 401 (Ct.Cl. 1982), cert. denied, 460 U.S. 1037 (1983); but see In re American Pouch Foods, Inc., 769 F.2d 1190, 1196 (7th Cir. 1985), cert. denied, 475 U.S. 1082 (1986)

219. Marine Midland at 399, "[T]he government takes an interest in the contractor's inventory but does not want, and does not take, any of the responsibilities that go with ownership."

220. Marine Midland at 397, 398; see also Armstrong v. U.S., 364 U.S. 40 (1960)

221. Marine Midland at 404

222. See e.g. In re Double H. Products, 462 F.2d 52, 55 (3rd Cir. 1972) (In a case prior to Marine Midland, the court held that the title vesting provisions in the contract transferred actual title, not a lien, despite the creditor bank's specific argument that the title should only be considered a security device.); In re American Pouch Foods, Inc., 769 F.2d 1190, 1196 (7th Cir. 1985), cert. denied, 475 U.S. 1082 (1986) (post

Marine Midland decision)

223. *Armstrong v. U.S.*, 364 U.S. 40 (1940)

224. See Uniform Commercial Code, Article 9-203(1), which states in part:

(1) [A] security device is not enforceable...with respect to the collateral and does not attach unless:

(a) the collateral is in the possession of the secured party pursuant to agreement, or the debtor has signed a security agreement...;

(b) value has been given; and

(c) the debtor has rights in the collateral.

[emphasis added]

225. This issue can best be framed by considering supplies, equipment, and inventory obtained after the government contract is formed. Since even a security interest previously created to apply to after acquired inventory will not attach until the debtor obtains rights to the property, if the property is allocable to the contract at that point in time, the Government's title will vest, preventing the competing lender's security interest from attaching.

226. Other than the Claims Court, only one reported federal decision does not treat the Government's interest as actual title. In *U.S. v. Lennox Metal Manufacturing*, 225 F.2d 302, 317 (2d Cir. 1955), the court ruled that since the Government had in bad faith terminated a contract for default, it was barred by the "unclean hands" doctrine from enforcing the "equitable title lien." The court's desire to do equity resulted in this mischaracterization of the Government's title in the contract property.

227. Marine Midland at 402, referring to In re Double H. Products, Corp., 462 F.2d 52 (3rd Cir. 1972)
228. In re Double H. Products, Corp., 462 F.2d 52, 55 (3rd Cir. 1972)
229. Marine Midland at 404
230. See In re American Pouch Foods, Inc., 769 F.2d 1190 (7th Cir. 1985), cert. denied, 475 U.S. 1082 (1986)
231. Clearfield Trust Co. v. U.S., 318 U.S. 363 (1943)
232. Id. at 367
233. Supra note 205, and accompanying text
234. U.S. v. Kimbell Foods, Inc., 440 U.S. 715 (1979)
235. Id. at 728, 729
236. Id. at 740;
237. In re Murdoch Machine & Eng. Co. of Utah, 620 F.2d 767 (10th Cir. 1980)
238. Id. at 772
239. See Marine Midland Bank v. U.S., 687 F.2d 395, 404 (Ct.Cl. 1982), cert. denied, 460 U.S. 1037 (1983)
240. Id. at 403, n. 8
241. 1958 U.S. Code Cong. & Admin. News 4021, "[I]mprove...procurement through the promotion of greater uniformity and simplicity...", 4027 "It is contemplated that uniform government-wide regulations will be developed..."
242. Welco Industries, Inc. v. U.S., 8 Cl.Ct. 303 (1985), aff'd, 790 F.2d 90 (Fed. Cir. 1986)
243. First National Bank of Geneva v. U.S., 13 Cl.Ct. 385 (1987)

244. See White, Dancing on the Edge of Article 9, 91 Comm. L. J. 385 (Winter 1986); White states that the U.S. Supreme Court in Kimbell Foods, has settled the question in favor of incorporating state law as the applicable federal law governing lien and security interest priorities. He goes on to heavily criticize the holding in American Pouch and questions why the courts continue to protect the "country's largest and nastiest creditor." at 394. However, White does not answer the specific bases relied on by American Pouch and Marine Midland for not adopting state law, and he ignores the consistent judicial interpretation of the title vesting provisions.

245. U.C.C. §9-102(1)(a); see also Official Comment 1

246. Nash and Cibinic Report, Vol.2, No. 1, p5 (Jan 1988), quoting Clark & Clark, Secured Lending Alert, Vol.3, No. 10 (Dec. 1987)

247. In re Murdoch Machine & Eng. Co. of Utah, 620 F.2d 767, 772 (10th Cir. 1980)

248. See generally Nash & Cibinic Report, Vol. 2, No. 1, p5 (Jan. 1988); Despite certain commentators statements that since the Government complies with recording laws as a lender in the S.B.A. and F.H.A. loan programs, it should comply as a buyer, this approach ignores the nature of procurement and the practical results of compliance. Unlike the Government's lending programs, which mesh with the complimentary state laws, Government procurement is an international multi-billion dollar system which is geared to one uniform federal approach. The magnitude of this task alone sets government acquisition apart from most commercial transactions. Due to the impact of literally thousands of sometimes conflicting statutes,

procurement is already too complex a system for real commercial efficiency, and the addition of yet another layer of contract administration would only result in additional cost and confusion.

249. See e.g. In re Double H Products, Corp., 462 F.2d 52, 55 n.4 (3rd Cir. 1972); see also c.f. 50 U.S.C. App. 2071(a) (1975); 15 C.F.R. §§350.3-350.13, Industrial Mobilization Regulations and the Defense Priorities and Allocations System

250. See generally FAR 32.5

251. See U.C.C. §§9-302, 305

252. See U.C.C. §9-303

253. 11 U.S.C. §1129(b)

254. At least when the Government is faced with a situation where property it has some interest in is taken pursuant to state law, a remedy is available under 40 U.S.C. §308 to recover the property pending resolution of a claim against the Government for its value. The Government is not allowed to use this provision against a federal proceeding however. See e.g. The Revenue Cutter, D.C. Or. 1876, 20 Fed. Cas. No. 11, 712. (Case in admiralty was not a proceeding under state law, so the Government was not entitled to possession.)

255. See e.g. Marine Midland Bank v. U.S., 687 F.2d 395, 397, 398 (Ct.Cl. 1982), cert. denied, 460 U.S. 1037 (1983)

256. Supra note 111, and accompanying text

254. See The Government Contractor, Vol. 30, No. 1, Jan. 4, 1988.

255. Despite occasionally harsh results, the Government may contract as it wishes. Such a specific contractual provision purporting to pass actual title would be valid and enforceable. See e.g. In re American Boiler Works, 220 F.2d 319 (3rd Cir. 1955) (In the absence of constitutional limitation, the Government can contract as it desires, despite harsh results in application)

## APPENDIX 1

The Progress Payments Clause (Aug 1987) found at FAR 52.232-16 should be amended to read as follows:

(d) Title. (1) Title to the property described in this paragraph (d) shall vest in the Government. ["Title" as used in this clause means actual title, and not mererly a security interest, lien, or equitable interest.] Vestiture shall be...